

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

REVIEW OF FOREIGN DEVELOPMENTS

January 14, 1947

Argentine-Chile Economic and Financial Agreement...	1
<del>Export Credit and Transfer Guaranties</del> .....	<del>9</del>
The Exchange Value of the German Mark.....	14
Financial Policies of the Argentine Central Bank...	19

~~W. F. ...~~  
JH

.....

This review is intended primarily for internal circulation, and should in no case be cited or quoted. It consists of personal and informal contributions by the authors, which in many cases represent very tentative analyses of the subjects considered.

.....

Argentine-Chile Economic and Financial Agreement

David L. Grove

On December 13, 1946, the governments of Argentina and Chile signed a highly important Agreement on Economic and Financial Cooperation, the purpose of which was declared to be to strengthen the economic and financial ties which unite the two countries.

The signatories grant each other broad customs concessions, transit rights, and certain privileges in the fields of communications, insurance, motion pictures, and banking. In addition, Argentina is to lend Chile 700 million Argentine pesos (roughly 175 million United States dollars) for the following purposes: 100 million pesos in the form of a revolving credit, for a period of two years, to cover Chilean trade deficits with Argentina; 300 million in the form of a capital contribution, for a period of 50 years, to a joint Argentine-Chilean Financial Association which is to finance Chilean industries so that they may expand their output and export to Argentina; 300 million in the form of a loan, to be amortized over a period of 25 years, for a public works program consisting largely of railroads and highways which will link the two countries together.

The apparent significance of the Argentine-Chile Economic and Financial Agreement may be summarized as follows:

(a) Chile will be provided with funds with which to develop its timber, coal, and iron resources and its transportation facilities at a more rapid rate than might otherwise be possible. The direction of development of the Chilean economy, however, will have to conform, to a much greater extent than heretofore, with Argentina's economic requirements. This need not be undesirable from Chile's standpoint, but it does place that country in a more difficult position to resist any unreasonable political demands which Argentina might make in the future.

(b) Argentina emerges as a creditor nation ready to finance the economic development of other Latin American republics.

(c) Chile assumes heavy additional financial obligations. Servicing the 300 million peso public works loan will, by itself, add nearly 4.7 million United States dollars to Chile's annual needs for exchange. To this must be added interest on the investments of the Financial Association and, two and a half years after the Agreement goes into effect, repayments of the revolving credit. It would seem that the financial obligations assumed under this Agreement, together with present and prospective obligations to the Export-Import Bank for loans outstanding or authorized, will come quite close to exhausting Chile's capacity for borrowing with any reasonable likelihood of repayment.

1. Trade Provisions. With the exception of certain items appearing on a list to be prepared by each of the countries and submitted to the other within 180 days from the date on which the Agreement enters into force, all goods imported by either country from the other are to be free of custom duties and other taxes. It is worthy of note that, although provision is made for removing items from the original list of exceptions, no provision is made for adding new items.

Recognition is made of the fact that the exportation of goods which are in relatively short supply in the producing country will have to depend on the existence of a surplus after domestic needs have been satisfied. Each government will, therefore, periodically fix and communicate to the other the quantity of such products which may be imported from it within a specified period of time. Each country promises to give preferential attention to the domestic needs of the other in the allocation of exportable surpluses.

The concessions and advantages which each of the partners grants to the other under the present Agreement are to be denied to all other countries with which they may now or later have most-favored-nation agreements. This provision appears not to conflict with the United States-Argentine Trade Agreement which provides that: "The advantages now accorded or which may hereafter be accorded by the United States of America or the Argentine Republic to adjacent countries in order to facilitate frontier traffic ..... shall be excepted from the operation of this Agreement."

The Agreement states that Argentina and Chile are forming a customs union. The provisions on which this statement is based have been summarized in the three preceding paragraphs and fall far short of establishing a real customs union. The requirements of a customs union have been defined as follows: "Uniformity of customs law and customs territory vis-à-vis third States; freedom from import and export duties in the exchange of goods between the partner States; apportionment of the duties collected according to a fixed quota." <sup>1/</sup>

---

<sup>1/</sup> The Case of Customs Regime Between Germany and Austria, Permanent Court of International Justice, SER. A-B, Number 41, at 18 (Advisory Opinions, 1931).

The elimination of duties on most products is not likely to increase Argentine-Chilean trade substantially in the near future. In the past, only a very small fraction of the total trade of the two countries was with each other. The chief purpose of these concessions appears to be to create a preferred position for the products of the new industries of the two countries in each other's market. This preferred position will become increasingly important as the output of these industries expands and as the competition of the larger industrial countries becomes stronger.

Of much more immediate importance are the provisions which state that the contracting parties are to give preferential attention to each other's domestic needs in the allocation of their respective exportable surpluses. Argentina is primarily concerned about receiving Chilean copper, coal and, to a lesser extent, lumber and iron. Chile, on the other hand, is badly in need of Argentine wheat, corn, vegetable oils, and meat.

2. Provisions Pertaining to Communications, Insurance, and Motion Pictures. The means of transportation of each country are to enjoy most favored treatment in the territory of the other. Each government grants to the other free transit through its country for products exported to, or imported from, third countries. It would appear that Argentina will benefit most from these provisions because the relatively highly populated centers in the western part of Argentina, such as Mendoza, Tucuman, and Salta, will henceforth be able to import goods more cheaply via the west coast, through Chilean ports. They will also facilitate exportation of the cattle, wheat, and other products of these regions. On the other hand, there are very few cases, if any, in which Chile will find it advantageous to import from, or export to, third countries via Argentina.

The countries also grant to each other, for a period of 50 years, concessions and facilities necessary for the organization of special zones and free warehouses in their ports of entry. This provision will prove quite valuable to Argentina, which plans to make substantial use of the Chilean port of Valparaiso and perhaps some use of other Chilean ports. Chile, on the other hand, is unlikely to have much interest in having similar facilities in Argentina.

Both countries pledge that, during the term of the Agreement, the exchange of products between them will take place preferably in vessels of Argentine and Chilean registry with equal tonnage for the vessels of each. Even in the case of merchandise imported from or exported to third countries, similar preference will, in so far as possible, be given to Chilean and Argentine ships.

Commercial air communications between the two countries are to be promoted and facilities and authorizations necessary for this purpose are to be granted on a reciprocal basis.

Each country reserves the right to have its own insurance companies insure the transportation of products imported from the other for the account of the buyer or exported to the other for the account of the seller. With regard to reinsurance operations negotiated abroad, both governments are

to adopt measures so that such operations by firms in either of the two countries will be undertaken preferentially in the other.

The two governments will also seek to assure a greater interchange of motion pictures.

3. Financial Provisions. (a) Revolving credit. The Government of Argentina, through the Argentine Institute for the Promotion of Trade, grants the Government of Chile a revolving credit of 100 million Argentine pesos (roughly 25 million United States dollars) for a period of two years. Funds drawn on the credit will bear interest at the rate of 2.75 per cent per year and may be used only to cover an unfavorable balance of trade with Argentina. No more than 50 million pesos may be used in either of the two years over which the credit is to run. Interest payments are to be made quarterly, with the first payment to be made 90 days after the date of the first drawing on the credit. At the end of the two years, Chile is to repay the amounts borrowed in four equal installments at six-month intervals. Interest and amortization payments are to be made in Argentine currency obtained through the sale in Argentina of gold coin or bullion or freely convertible currencies. The Government of Chile may at any time make extraordinary amortizations provided that in each case such repayments are not less than one million pesos. It is expected that Chile will use all, or nearly all, of this 100 million peso credit over the next two years, inasmuch as its trade deficit with Argentina in 1945 and 1946 was in the neighborhood of 40 to 50 million pesos annually.

The Chileans expect to obtain funds with which to repay this credit from two sources:

(1) Receipts derived from the exportation to Argentina of the products of Chile's new industries, such as lumber, coal, and steel;

(2) Argentine pesos obtained from local expenditures of the proceeds of the 300 million peso loan and from similar expenditures of the Financial Association, both of which are discussed at length below.

(b) Argentine-Chilean Financial Association. The Argentine Government, again through its Institute for the Promotion of Trade, is to establish a Financial Association with the Chilean Development Corporation. The Association is to be governed by a Board consisting of a chairman and six directors. Three of the directors will be of Chilean nationality and will represent the Chilean Development Corporation; the remaining three will be of Argentine nationality and will represent the Argentine Institute for the Promotion of Trade. The Chairman is to be of Chilean nationality and will be chosen by unanimous agreement of the other members of the Board. In case of disagreement, the Chairman of the Board will be appointed by the President of Chile. The capital of the Association is to be 300 million Argentine pesos (approximately 75 million United States dollars), all of which is to be supplied by the Argentine Government. The purpose of the organization is declared to be to provide a means by which Argentina may collaborate "in the creation of new economic activities in Chile and in the strengthening of existing ones, in order to increase the exportation to

Argentina of Chilean products, especially copper, iron, steel, nitrate, coal, wood, and electric power, all from the point of view of close co-ordination between the economies of the two countries."

The Association's activities will consist of financing Chilean organizations, both old and new, through capital contributions, loans or any other means, in order to increase the exportation of Chilean products to Argentina.

All individual operations must be approved by the unanimous vote of the Board. Each side thus has a vote power over the activities of the organization. One of the conditions to be attached to each operation is that the Association will have preference in purchasing from the entities which it finances all of their output not needed to cover Chilean domestic requirements. The Government of Chile promises to permit the exportation to Argentina of products thus acquired by the Association.

The Association is to last for a period of 50 years from the date of its organization. At the end of this period, the Government of Chile guarantees that the capital contributed by the Argentine Institute for the Promotion of Trade will be returned to it in full. In the meantime, Argentina is to receive a minimum of 4 per cent interest per year on the amount actually used in financing Chilean entities. If the profits of the Association exceed 4 per cent in any fiscal year, the excess is to be distributed equally between the Chilean Development Corporation and the Argentine Institute for the Promotion of Trade.

The above provisions pertaining to the Financial Association make no reference to the specific projects to be financed, although they do mention the products in which Argentina is especially interested. Reports from various semi-official sources do, however, mention some of the projects contemplated:

(1) Development of lumber and wood products industries in south-central Chile. Although Chile has requested 6 million dollars from the International Bank for the development of her forest industries, it is stated that the needs of the Argentine market for lumber and wood products are so great that a still larger investment is justified. This may indeed be true for the long run, but it appears unlikely that the program contemplated with funds from the International Bank could be substantially expanded during the next five years or so.

(2) Development of Chile's potentially significant coal resources, both for domestic consumption and for exportation to Argentina.

(3) Expansion of steel production. With funds obtained through the Export-Import Bank, Chile is building a steel plant at Concepcion with an initial annual capacity of about 180,000 tons. The output of this plant would take care of nearly all of Chile's domestic requirements but would not be large enough to permit exports to neighboring countries. The mill has been so designed, however, that with a very small additional investment the annual output could be doubled. Argentina would provide a ready market for this additional output if Chilean delivered prices are competitive.

The Chileans maintain that they could effectively meet foreign competition, particularly in the western and northwestern parts of Argentina. Thus, the expansion of the Chilean steel industry might well prove to be advantageous to both countries.

(4) The expansion of output of copper products. By expanding her relatively small existing fabrication facilities, which were financed with the aid of the Export-Import Bank, Chile hopes to be able to supply part of the Argentine market, and perhaps also that of some other neighboring countries.

It would appear that, through the Financial Association, Chile will receive badly needed financial assistance under very favorable terms. The need for exchange resources to cover the interest payments should be more than met by the increased exports made possible by the expansion of the industries mentioned above. No amortization payments need be made for fifty years. Argentina will, to some extent at least, be committed to purchase part of the export surpluses of these industries and may even be forced to do so in times of depression if Chile is to service the other financial obligations incurred under the present Agreement (i.e., the revolving credit of 100 million pesos and the public works loan of 300 million pesos, which is discussed below). Should a world-wide depression occur, Chile would have exportable products which Argentina would need and for which it would probably be only too happy to exchange wheat, meat, and other agricultural products which Chile must import. Thus, it would appear that the activities of the Financial Association will help to develop Chile's economy in a way which will enable Chile not only to produce a larger part of its own domestic requirements but also to increase its exports to Argentina. This should be to the mutual advantage of both countries and will not involve any serious financial burden during the period in which the new industries are being established or expanded.

(c) Loan for Chilean Public Works Program. The Argentine Institute for the Promotion of Trade, through the Central Bank of Argentina, will purchase Chilean Government bonds up to a nominal value of 300 million Argentine pesos (approximately 75 million United States dollars), at a price of 96 per cent net. The bonds will bear 3.75 per cent interest annually, and will be cancelled in twenty-five years at the latest through semi-annual amortizations which will be made by purchase or bid when the bonds are quoted below par or by drawing when they are at or above par. Interest and amortization payments will be made in Argentine pesos in the offices of the Bank of the Argentine Nation. The bonds are to be payable to the bearer and will be quoted only in Argentina. The Argentine Central Bank reserves the right to determine the conditions under which the securities will be placed on the Argentine market.

The loan is to represent a direct obligation of Chile, which pledges the "good faith and national income of the nation." It should be noted in passing that this very general provision is the only guarantee mentioned. Argentina is not given control over any specific revenues nor over the output of any industries, notwithstanding the impression to the contrary given by various newspaper and magazine articles on the subject.

The proceeds of the loan are to be utilized exclusively to carry out a program of public works in Chile destined "to promote and coordinate" Argentine-Chilean trade. The selection of the public works to be financed is to be made by the unanimous vote of the members of a mixed committee formed by three representatives of each government. Argentina agrees to carry out the public works necessary in its own territory to complete those undertaken in Chile.

The Chilean Government must purchase from the Argentine Institute for the Promotion of Trade whatever machinery, materials, and equipment it finds necessary to import for the public works to be carried out under this loan, unless better quality or lower prices can be obtained elsewhere. In the latter eventuality, Chile may convert the Argentine peso proceeds of the loan into pounds sterling or United States dollars through the Argentine free market at the rate quoted on the date on which each operation is carried out. The free-market rate in Argentina is, in practice, controlled by the Central Bank, which enters the market from time to time and forces the rate up or down in accordance with its monetary and exchange policies. Should Argentina be losing reserves or should it for any other reason desire to prevent, or at least hinder, Chile from converting the peso proceeds into dollars or pounds, it could do so quite effectively by having the Central Bank force the free rate up whenever Chile entered the market. Although this is a technical possibility, it is probably quite unlikely to occur in practice. What is more likely to occur is that the free rate might, for entirely different reasons, be high at a time when Chile needed exchange. Unless the Argentine Central Bank were to grant a special concession, Chile might find itself forced to pay an unexpectedly high price for the dollars or pounds needed to finance imports for the public works program.

The Agreement makes no mention of specific projects to be financed with the proceeds of the loan. Semi-official sources, however, have reported that the following projects will be undertaken:

(1) A uniform-gauge railroad from the port of Valparaiso in Chile to Mendoza, in Argentina, which will eliminate the transshipments now made necessary by the fact that the present Chilean gauge on this line is different from the Argentine one.

(2) A new and longer tunnel will be cut through the mountains on the rail route between Valparaiso and Mendoza, at a much lower level than the existing one. Since only one-third of the proposed tunnel will lie in Chile, the cost of the remaining two-thirds will have to be borne by Argentina.

(3) A railroad from Antofagasta, in northern Chile, to Salta, in northwestern Chile. *Argentina?*

(4) A railroad from Concepcion, in south-central Chile, to the territory of Neuquen in Argentina.

(5) The construction of warehouses and terminals along the above-mentioned lines.

(6) A highway from La Serena in Chile to San Juan, in Argentina, and other roads the location of which has not yet been reported.

(7) The construction of dock facilities at the port of Valparaiso.

The railroads and highways will provide outlets for the agricultural products of many parts of Argentina, some of which have hitherto been relatively isolated. In many cases it will also make possible cheaper imports. Chile will benefit from these roads in three ways: first, it hopes to be able to purchase Argentine wheat and livestock at somewhat lower prices; secondly, it will collect freight and dock charges from Argentina for its exports to and imports from third countries (particularly Peru and Ecuador) via Chile; and, thirdly, it expects that the improved railroad and highway facilities will attract many additional Argentine tourists to Chile.

It is questionable whether these public works will produce enough foreign exchange to service the loan. They will, however, lead to closer economic relations between the two countries and will have even greater significance as their economies develop and the possibilities of trade between them increase.

4. Final Provisions. All purchases of Argentine products by the Chilean Government, either directly or indirectly under the terms of this Agreement, are to be made from or through the Argentine Institute for the Promotion of Trade, unless the latter prefers that they be made from other institutions or export firms established in Argentina.

Both countries agree to facilitate establishment in their respective territories of branches or agencies of banks or official organizations of the other country.

It has been officially announced that the Agreement will enter into force in March. The Agreement is to remain in force for a period of five years from the date on which it becomes effective except as otherwise explicitly stated in the text. It will be renewable from year to year by mutual consent, but after the first five years may be terminated at any time upon three months' notice.



Export Credit and Transfer Guaranties

M. J. Roberts

In May 1946 Senator Pepper introduced a bill providing for establishment of a government export credit and transfer insurance system in this country. The bill was referred to the Senate Banking and Currency Committee but no action was taken by the 79th Congress. It is possible that during the present session, pressure may be exerted for early consideration of this proposal.

Prior to the introduction of this export insurance bill, there was considerable discussion among trade and government circles regarding the merits or drawbacks of such an insurance program, but interest in the scheme has since diminished. Last summer the Export-Import Bank conducted an informal survey of opinion among exporters, bankers, and trade associations to determine their reactions to such a program. In November, at the National Foreign Trade Convention, August Maffry, Vice President of the Bank, announced that the Bank's survey showed little demand on the part of exporters for government guaranties against losses on short-term credits due to insolvency of foreign importers or nonpayment of their obligations for other causes. He reported that, as part of its regular export financing program, the Bank is prepared to grant nonrecourse loans to exporters to finance transactions requiring the extension of medium- or long-term credits, thereby relieving them of both credit and transfer risks.

The Bank found, however, that there is a "genuine and widespread interest among exporters in a government system of transfer guaranties." Such transfer guaranties would protect exporters against losses from nonpayment by foreign importers arising from their inability to obtain dollars in exchange for their own currencies. In the past the Bank has repeatedly stated that its powers are sufficiently broad to permit it to institute a system of transfer guaranties without specific enabling legislation. At present, the Bank is still studying the advisability of offering transfer guaranties. If the establishment of a system of transfer guaranties seems to be merited and if its introduction receives the support of other government agencies and departments, the Bank may wish to go ahead with the scheme before Congress can act on the proposal of Senator Pepper. The Bank does not appear to favor the Pepper bill since it makes the extension of both export credit and transfer insurance mandatory upon the Bank.

From its survey, the Bank concluded that any demand for short-term export credit guaranties should be met by private initiative. Private facilities should be improved by strengthening private guaranty organizations, pooling credit information, further development of private export credit services, use of credit facilities of export houses and improvement of credit information collected by individual firms. With regard to government transfer guaranties, however, the Bank's survey showed that many exporters would avail themselves of such guaranties if available and that there is a demand for transfer guaranties covering medium- and long-term export commitments as well as short-term export transactions. Most exporters expressed preference for a system which would offer a blanket guaranty covering all their export transactions regardless of term or country of destination.

The Bank concluded, as a result of its survey, that the exporter should be required to carry some portion of the transfer risk in order to insure that due caution would be exercised in the selection of the risks to be guaranteed. The determination of rates to be charged would present some difficulty; rates should be low enough to attract a volume of business sufficient to permit a satisfactory spread of risks by countries, and high enough to make the system self-supporting. Rates should vary with the credit terms extended and by the country distribution of an exporter's transactions. The Bank stated that transfer guaranties should not be limited to transactions with countries which are considered prime risks but on the other hand should not serve to encourage exports to countries which offer poor prospects of prompt dollar payments. It would not necessarily limit transfer guaranties to transactions with countries which are members of the International Monetary Fund<sup>1/</sup> since there are important trading nations with good credit records outside the Fund.

Provisions of the Export Insurance Bill. The export insurance bill introduced by Senator Pepper would establish a division within the Export-Import Bank, to be called the Foreign Trade Insurance Division, to administer the insurance program. For its insurance operations this Division would have an insurance capital stock of \$100,000,000 to be subscribed by the United States Government upon call by the Bank's Board of Directors. The total amount of insurance outstanding at any one time could not exceed five times the amount of the insurance capital stock, or \$500,000,000.<sup>2/</sup>

According to the bill, the Bank would be empowered to write insurance covering payments due any United States exporter from any foreign buyer. At its discretion, it could insure payment to exporters directly, reinsure private companies which have issued export insurance policies, or participate with private insurers in writing insurance. The Bank would insure against both the transfer risk and the risk of non-payment by the importer for any other cause. As defined in the bill, the transfer risk is the risk of non-payment by reason of the imposition by a foreign government of exchange block or other exchange control preventing the foreign purchaser from securing dollar exchange to pay his obligation. The risk of non-payment for any other reason would include the risk of insolvency of the foreign buyer or his protracted default.

The bill sets a maximum coverage for both the credit and the transfer risk. Against the transfer risk, the Bank may insure up to 100

---

<sup>1/</sup> It might be noted that the Articles of Agreement of the Fund provide that during the transition period exchange restrictions may be maintained and adapted to changing circumstances and enemy-occupied countries may introduce restrictions if conditions warrant. Following the transition period, member countries may not, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions. There is one exception: if any any time any currency is declared scarce, all members are authorized temporarily to impose limitations on exchange operations in the scarce currency.

<sup>2/</sup> This limit on outstanding insurance compares with a maximum of £200,000,000 under the British export insurance system and \$100,000,000 under the Canadian system.

per cent of the contract price;<sup>1/</sup> against the risk of non-payment for any other cause, the Bank may insure up to 90 per cent. The bill further provides, however, that it is the policy of Congress that the insured retain a substantial interest in the discharge by the purchaser of the agreed terms of the sales contract. This provision would presumably be interpreted to mean that credit insurance should not cover the exporter's profit.

It is the specific intent of the bill that the Export-Import Bank should make available both export credit and transfer insurance covering exports of all classes of commodities and that this insurance should be extended as expeditiously as possible and on reasonable terms. Thus, even though the Bank has found there is little need for export credit insurance, it would seem that the Bank would have to write policies bearing reasonable premiums covering credit risks if so requested by exporters or private insurers. The Bank would, however, be free to exercise its discretion in the formulation of specific programs and procedures, notably the types of policies written, the extent of coverage, premium rates, definitions of risks covered, eligibility, etc. With such freedom of decision, the Bank would be able to offer insurance policies covering a smaller percentage of either the credit or transfer risks than the permissible maximum.

In addition to these provisions outlining the scope of the export insurance contemplated and the powers of the administering authority, the bill provides that the Export-Import Bank shall, in so far as practicable, maintain in major export centers regional representatives to advise exporters on its policies and practices. This provision for regional representatives is not mandatory upon the Bank. It has been suggested that instead the Bank might use the regional offices of the Commerce Department or perhaps the Federal Reserve Banks as its agents. In April 1946, August Maffry, Vice President of the Bank, stated that if and when the Bank established an export insurance program, applications would probably be routed through commercial banks and the Federal Reserve Banks.

On at least one important point the bill as introduced in the Senate differs from an earlier draft bill that had been widely circulated among exporters and bankers for their comment and criticism. The earlier bill had included a clause providing that the insurance would become effective only after the goods underlying the credit transaction had been accepted by the foreign purchaser. This clause has been eliminated, reportedly at the instance of many exporters and bankers who considered that it would be preferable for the insurance to vest at the time the draft is accepted by the buyer. If the insurance became effective at the time of acceptance of the draft, the risk of later nonacceptance of the goods would be covered. Under the provisions of the present bill, the Export-Import Bank, as the administering authority, may determine when the insurance cover will become effective.

---

<sup>1/</sup> As defined by the bill, contract price includes "any insurance, freight, or other charge paid or to be paid by the exporter, and charges for services furnished by the exporter as an incident of the export sale."

Arguments Pro and Con. The arguments advanced in favor of government export credit and transfer insurance are well summarized in the title of the Pepper bill, "To encourage fuller participation by small business concerns in soundly expanded foreign trade and to aid in maintaining high levels of employment in the United States." The report of the Foreign Trade Subcommittee of the Senate Small Business Committee, which has championed the export insurance proposal, points out that many manufacturers in the capital goods field, including small producers, have come out of the war with greatly expanded capacity. The report states that sharply expanded export markets must be developed in order to avoid the danger of depression which might arise from the disuse of available capacity. In developing and maintaining such markets export credit insurance would be invaluable, in the Subcommittee's opinion, since it would make possible the granting of longer credit terms and would facilitate financing of transactions through commercial banks. The insurance would assist exporters of consumer goods to compete in foreign markets by offering the same credit terms as are offered by exporters in foreign countries whose governments provide export credit insurance. According to the report, a chief beneficiary would be the small exporter whose trade has been curtailed because of inadequate financial resources. With insurance he should be able to get additional commercial bank financing which would permit him to expand his export business without increasing his capital or his risks.

The report attempts to substantiate its claims regarding the benefits of export credit and transfer insurance with material from the study on export financing made at the request of the Subcommittee by the Federal Reserve System. In its survey of banker opinion, the Federal Reserve System found that a large majority of the banks interviewed would be interested in financing more exports with export insurance. Many of the banks expressing favorable opinions, however, were banks doing a relatively small amount of export financing, and a number qualified their replies by stating that their additional financing with insurance would be small. Many banks indicated, however, that they would be willing to purchase or discount drafts without recourse up to the amount of the insurance coverage. With qualification, a majority of the banks stated that with insurance they would be willing to finance drafts running for six months to one year and almost one-half stated they would finance drafts running for more than one year under certain conditions. Such financing would be contrary to present practice for the survey showed that banks do not customarily finance drafts of more than six months maturity. About one-half of the banks interested in doing more export financing with insurance believed that with insurance they might finance at lower rates. The saving from lower rates might or might not be sufficient to offset the cost of the insurance.

In assessing the need or desirability of instituting government export guaranties, a distinction must be made between guaranties against credit risks and guaranties against the transfer risk. With regard to insurance against credit risks, it is doubtful whether a majority of exporters favor it. Losses of exporters owing to insolvency of the importer have been exceedingly small, reportedly averaging less than one-half per cent of total credits during the period 1937 to 1940.<sup>1/</sup> The Foreign Trade Subcommittee of the Senate Small Business Committee stated in May 1946

---

<sup>1/</sup> Survey among members conducted by Foreign Credit Interchange Bureau.

that "a great number of exporters and bankers and their trade associations support the establishment of such a system now by the Federal Government." On the other hand, the Export-Import Bank in its recent survey found that "many individual exporters and the major trade organizations have expressed themselves to the bank either as opposed to a government system of export credit insurance or as believing it to be unnecessary." It has been suggested that a system of export credit and transfer insurance would enable small manufacturers to enter the export trade where they are now excluded either because of their inability to cope with foreign credit problems or because of the unwillingness of their banks to provide the necessary financing for such transactions without insurance. Considerable doubt has been expressed, however, as to whether many small domestic firms would be enabled to enter the export business merely as a result of the creation of insurance facilities.

On behalf of export credit guaranties, it has been argued that they would stimulate United States export trade. At the present time there seems to be no necessity to encourage exports for there is no lack of foreign markets for United States goods. Foreign demand is limited principally by the supply of dollars available to pay for United States products. This supply has been augmented by credits to foreign countries to finance urgent reconstruction and development requirements. Instead of developing means of increasing exports, it might be sounder policy to institute a program designed to stimulate imports. With dollar funds augmented in this way, foreign countries would be able to continue purchasing a large volume of United States goods, thereby maintaining United States exports at a high level.

With regard to government guaranties against the transfer risk, there is no doubt that the majority of exporters believe that such guaranties would relieve them of a risk which they are unable to appraise, and that such guaranties, if available, would be widely employed. It has been suggested, however, that if countries would agree that any new exchange restrictions imposed would not be retroactive, that is, would not apply to contracts previously entered into between exporters and importers, the transfer risk would be largely eliminated. The International Monetary Fund might initiate action by trying to get its members to reach such an agreement, either among themselves or with the Fund. If such a system of agreements could be developed, it might provide the best solution for the exporters' problem with regard to transfer risks.

The Exchange Value of the German Mark

J. Herbert Furth

In the agreement of December 2, 1946, which provides for the economic merger of the American and British zones of occupation, the occupying powers have decided to establish the exchange value of the German mark "as soon as this is practicable".

Establishing an exchange rate for the German mark poses problems different from those present in most similar cases. Germany is not suffering from rapid increases either in prices or in currency circulation. Her economy has long been insulated, first by the autarkic policy of the Nazi regime, later and more thoroughly by the war, and finally most completely by the occupation. While the task of finding an adequate rate is more difficult, the immediate impact of the rate on the economy probably would be less than in other countries.

The existence of an exchange rate is not an essential prerequisite for the revival of German foreign trade and the rehabilitation of the German economy.<sup>1/</sup> At least during the period of occupation German economic policy will be based on government planning rather than on reliance upon the automatism of a free market. In such a planned system, the international and the domestic value of the mark can be completely separated. The Export-Import Agency set up by the merger agreement will accept payment for exports only in dollars or sterling, or in currencies convertible on demand into dollars or sterling. It will allocate its foreign exchange resources, including export receipts and "advances" from the occupying powers, to various classes of imports according to priorities consistent with the overall program of reconstruction. In so doing, it will eliminate the possibility of an unplanned deficit in the balance of trade of the merged zones. In relation to domestic sellers and buyers, the Agency will make its transactions exclusively in marks. In view of the limited volume of German exports possible and the relatively high level of imports planned under the merger agreement during the next few years, the Agency will have no difficulty in accumulating marks so as to avoid the danger of causing an expansion in the circulation of domestic currency by a deficit in its mark transactions.

Prices in foreign currency will be determined by the world market level, prices in marks by the domestic level, and the relation between these may and will be very different for different commodities and services. Wherever the domestic level--which is still based largely upon the "stop prices" of the pre-war Nazi regime--appears to reflect a price pattern too much out of line with the contemplated character of the future peacetime economy of Germany and especially with the contemplated program of peacetime foreign trade, the Agency can depart from existing prices so as to bring domestic price relationships closer to those characterizing the world market.

A fixed uniform rate of exchange between dollars or sterling and marks will be necessary only in a few cases, for instance, to provide mark currency for foreign visitors to Germany and for remittances. In the first case, the rate will be satisfactory if it approximates the relation between

---

<sup>1/</sup> See Hans J. Dernburg, "Calculations Concerning a Commercial Exchange Rate for the German Mark." This Review, June 17, 1946; p. 1.

German and foreign hotel prices, which may be very different from more general price ratios. In the second case, the rate should be fixed high enough (in terms of marks per dollar) to attract the greatest possible amount of remittances.

The practicability of separating the domestic from the foreign value of a currency has been demonstrated by the experiences of the Soviet Union and Nazi Germany. It is true that during the period of zonal division some difficulties are bound to arise because of the fact that trade with the French and Russian zones will fall neither into the category of domestic nor into that of foreign trade. Trade with the Russian zone, however, probably will continue to be on a barter basis in any case. Moreover, any establishment of exchange rates limited to the area of the two merged zones would be detrimental to the prospects of reunification of Germany. On the other hand, if it were considered feasible to establish a uniform rate for all of Germany, or at least for the three Western zones, it would certainly be possible to come to an agreement covering the more limited field of inter-zonal trade.

One disadvantage of the present separation of domestic and foreign price levels is the danger inherent in any interference with the system of international prices, namely, a maldirection of economic resources due to the impossibility of comparing cost and price relations in domestic and international markets. The German economy may fail to import those goods in which it is at the greatest economic disadvantage, and to export those in which it has the greatest comparative advantage. This shortcoming-- which the adherents of state control of foreign trade usually minimize-- will be less important in Germany than in most other countries. The program of Potsdam, with its limitations upon the largest German industries and its injunction against the German standard of consumption finding its natural level, will prevent the German economy in any case from developing along its most economical lines. A second disadvantage is the fact that the scheme can work only in conjunction with a virtual state monopoly of foreign trade. It is therefore contrary not only to the American concept of foreign trade policy, as set forth in the proposed charter of the International Trade Organization, but also to the principle of decentralization of economic power in Germany, laid down in the so-called Potsdam declaration.<sup>1/</sup> This reason in itself is important enough to warrant an attempt toward setting up a stable exchange rate between the mark and international currencies.

Present Exchange Rates and Potential Equilibrium Rates. Until recently, the most important ratio fulfilling some of the functions of an exchange rate was the "military rate," which valued the Allied military mark at 10 United States cents. In September 1946, however, the Commanding General of the United States Forces in the European Theater ordered all American personnel to use dollar script instead of military marks in transactions with American institutions. This move, aimed at black market activities of American personnel, abolished the main field of application of the military rate.

---

<sup>1/</sup> It is one of the major mysteries of allied policy toward Germany, how this principle can be reconciled with the Russian and British efforts toward setting up a communist or a state-socialist economy, respectively. Both plans would give a future German government even more centralized economic power than the Nazi regime enjoyed.

For commercial dealings, including the collection of service charges in international relations (transit traffic), military government authorities use ratios called "conversion factors" rather than exchange rates. These vary for different commodities and services, and correspond roughly to the relation between the domestic and the world market price of the commodity or service in question. Reportedly the ratios used most frequently are around 20-30 United States cents per mark. In view of the increase in foreign trade transactions which is bound to occur in consequence of the merger agreement a greater variety of such ratios is to be expected.

For a few transactions, e.g., payments to prisoners of war under the Geneva Convention, the pre-war rate of 1 mark equal to 40 United States cents may still be applied. Extra-legal ratios, especially the black market rates in Germany and more or less tolerated exchange rates in other European countries, are substantially lower than the military rate, and usually equate the mark to a fraction of one cent.

Under present conditions, any attempt to compute an equilibrium exchange rate is foredoomed to failure. All of the elements generally used in estimating such rates (price and income levels, circulation of money, balance-of-payments projections) are either inappropriate or unknown. On the basis of a comparison of legal prices in Germany with prices in the United States, the "purchasing power parity" of the mark would be around 35 cents. Legal prices, however, apply only to the meager official rations available. On the basis of black market prices, the "parity" would be as low as one-fifth of one cent. Certainly neither ratio would prevail if a legal free market in commodities or in foreign exchange were established. Similar discrepancies occur if a wage rather than a price parity is sought. On the basis of legal money wages, the "parity" would be in the neighborhood of the legal "purchasing power parity." These wage rates, however, are largely fictitious since entrepreneurs attempt to furnish extra allowances in the form of free meals or payment in kind.

Comparison of changes in money circulation would yield unsatisfactory results since such a procedure would disregard the fact that the present monetary situation is influenced more by the decrease in the supply of goods than by the increase in currency. The balance of payments of Germany as a whole cannot be forecast as long as the fate of the unification of the German economy is in doubt, and even the balances of the individual zones will be determined by political decisions of the occupying powers rather than by economic considerations. Moreover, at any given domestic price level, the equilibrium exchange value of the mark will be considerably lower if Germany is to have an export surplus in order to pay reparations, or repay occupation costs, out of current production, than if she is to develop an import surplus in order to rebuild her industries.

Principles of Exchange Stabilization. Military government sources have reportedly advocated an exchange rate in the neighborhood of 30 cents per mark to be established in connection with a proposed financial reform. This reform would include the conversion of the present mark into a new "German mark" at the rate of 10 to 1, the reduction of mark claims and liabilities in the same proportion, and the enactment of a capital levy of 50 per cent, the proceeds of which would be earmarked for compensating losses from



domestic war damages to the extent of approximately 30 per cent.<sup>1/</sup> According to its sponsors, such a plan would make it possible to limit increases in the present legal wage and price level to about 20 per cent, and thus to protect the interests of the recipients of fixed incomes. This assumption is unrealistic. Experience in all other countries has shown that currency reform in itself is insufficient to keep wages and prices at a low level. Even the most drastic reduction of the amount of currency in circulation in other European countries has had only a temporary effect, and within a few months the circulation has again reached a level only slightly lower than that prevailing before the reform, and definitely higher than the pre-war average. The main reasons for this development appear to be the tendency of both entrepreneurs and individuals to attempt to reestablish an accustomed level of cash balances, and unwillingness of the monetary authorities to risk a breakdown of the economic system by rigid resistance to reflationary pressure. Moreover, to prevent government revenues from drying up it has generally been necessary to permit payment of taxes out of blocked balances, which in this way are returned to circulation. It is true that strict economic controls could prevent reflation of the currency from influencing the level of legal prices, just as it has been possible so far to maintain legal prices at approximately the pre-war level. In that case, however, the currency reform would fail in its main purpose, namely, to prepare for the return to a market economy.

Currency reform and appropriate fiscal measures eliminate and reduce idle balances which constitute potential rather than actual sources of inflation. This function is very important insofar as it helps to avoid further deterioration in the monetary situation, but it does not close an existing "inflationary gap." The direct anti-inflationary effect depends principally on the restoration of confidence, which implies a decline in hoarding of commodities and an increase in money savings. These factors increase the supply of, and reduce the demand for, goods on the black market. The resulting drop in black market prices in turn curtails incentives for workers to engage in black market activities rather than in productive labor, and thereby improves the manpower situation and especially the efficiency of labor. These factors, however, are less important for the price level than changes in the supply of goods due to imports and domestic production. For this reason, a currency reform attempted before the restoration of nearly normal conditions of output and transportation will generally be less successful than one undertaken at a later stage of rehabilitation.

In the near future, the supply of consumer goods in Germany cannot be expected to reach more than, say, half of the pre-war level. On the other hand, neither money incomes nor the circulation of money can be reduced below the pre-war average without encountering sharp resistance. In view of the pent-up demand for goods, and the after-effects of the losses sustained by the holders of money and money claims in the course of the currency reform, the velocity of circulation would probably be higher than in war-time, and hardly lower than before the war. Under these conditions, the discrepancy between money income and money circulation on the one hand, and the flow of commodities on the other, may be expected to continue as long as prices do not rise by at least 100 per cent. It is true that the supply of goods will steadily improve, but experience shows that such a

---

<sup>1/</sup> See Commercial and Financial Chronicle, November 28, 1946, pp. 2754, 2786.

development usually gives rise to, and is facilitated by, a corresponding increase in money. For this reason, the attempt to maintain prices at present levels would frustrate efforts to restore a market equilibrium and hinder rather than further the progress of economic recovery. The exchange rates of the mark should thus not be based upon the assumption that prices will remain unchanged.

The protection of the interests of fixed income recipients would indeed be politically important since the urban middle classes, which include those income groups, should normally be the strongest supporters of a democratic system in the Western sense. Unfortunately, no monetary plan can protect these interests. It has been estimated that approximately five-eighths of the real capital of Germany has been destroyed. The destroyed part includes homes, furniture, and similar property mainly held by the urban middle classes. Moreover, the proposed financial reform will render all but worthless the bank deposits and government bonds which constituted the bulk of middle-class investment. Finally, countless enterprises will be razed under the terms of the Potsdam declaration, or have suffered from looting, requisitions, and confiscations under the denazification laws. The bulk of the urban middle classes will thus be completely ruined regardless of the future level of prices and it will be futile to base a price policy upon consideration for these classes.

The main goal of economic policy in Germany, and therefore also of the setting of exchange rates, should be to increase the productivity of the German economy within the framework of the interallied agreements. This means that the exchange rate should not be so high as to discourage German exports, and not so low as to make impossible German imports without endangering the domestic price structure. The German price level should not be adjusted to fit a given exchange rate, but the exchange rate should be set according to the level at which German prices are stabilized. This level cannot be predicted at present. It appears certain that it will be at least twice as high as before the war, but it may be much higher in case the increase in prices following the financial reform necessitates also an increase in money wages. Any general rate set before these price and wage fluctuations have ended would have to be revised within a short time, or it would interfere with the functioning of the domestic price system. In the first case, it would endanger public confidence in the new currency, and thus conflict with the main purpose of the monetary reform. In the second, it would make permanent a market disequilibrium that would hamper the restoration of a market economy and thus conflict with the main purpose of the establishment of an exchange rate.

Conclusion. The foregoing discussion may be summarized as follows:

1. For the moment, the establishment of an exchange rate is not necessary and would be impracticable. Neither legal nor black market prices and wages, neither changes in the circulation of money nor estimates of the balance of payments give any clue as to the equilibrium rate.
2. The arguments for fixing the exchange value of the mark in connection with the currency reform at approximately 30 United States cents are invalid. It would be impracticable to keep prices and wages at present levels, and impossible to protect the interests of fixed income recipients, no matter how high the exchange rate might be.

3. Regardless of the stringency of the currency reform, a reflation at least to the pre-war size of monetary circulation is to be expected. In view of the reduction in the flow of goods, this would make necessary a rise in the price level by at least 100 per cent unless the present strict control of the economy is to be maintained. If a rise in money wages is to be granted, the rise in prices would have to be correspondingly greater.

4. General exchange rates should be established as soon as the new level of prices and wages appears to be stabilized. Earlier attempts toward fixing general exchange rates either would lead to instability of the rates or would hinder reestablishment of a working domestic price system. The setting of general exchange rates, however, should not be delayed beyond that time in order to make possible the abandonment of state trading.

5. Until that time, foreign trade transactions should continue to be divorced from domestic transactions as completely as possible, and special rates used in those cases (travel, remittances) in which actual exchange transactions are necessary.

Financial Policies of the Argentine Central Bank

Robert A. Rennie

The Perón administration's first use of its powers under the new banking laws indicates a radical change from the conservative policies pursued under the management of Raul Prebisch. These changes appear to be the key to much of the financing of the Argentine Five Year Plan, which contemplates the expenditure of 1.3 billion pesos a year in addition to other government expenditures, which had reached the record sum of 2.8 billion pesos in 1945 (roughly 700 million United States dollars).

During the war, the then privately operated Central Bank played an important role in keeping Argentina's inflation to a minimum. From 1939 to 1944 Argentina's cost-of-living index had risen only 10 points. In 1945, however, the index began a spectacular climb, and recently the government ceased publishing the figures. Central Bank policy, before nationalization, was primarily designed to sterilize the large increases in bank reserves caused by the rise in foreign exchange holdings. The Bank sought to neutralize this major inflationary threat by selling Central Bank Certificates of Participation in Gold and Foreign Exchange to the commercial banks to mop up the excess reserves, and thus to prevent excessive credit expansion. Not only did the Central Bank sterilize bank reserves, but it in every way opposed unnecessary government expenditures while war-time scarcities existed. In its annual reports the Bank warned the government against bidding up the prices of scarce materials by large-scale public works and armaments programs.

The Perón government, meeting increasing resistance to its fiscal policy--the public bond market became seriously saturated in 1945 and the banks showed no interest in absorbing additional bonds--finally ordered the nationalization of the Central Bank and of all private bank deposits. The

decrees turned over to the Central Bank the deposits in the private banks and all the assets held as security for those deposits. The provisions virtually established the private banks as agents of the Central Bank, for which they conduct business for established fees. All loans and investments since the nationalization, except those financed with the capital of the banks, have been subject to the approval of the Central Bank, which, in effect, totally controls the credit of the country.

Under its new powers, one of the first acts of the Central Bank was to cancel the Central Bank Certificates, which amounted to 1.1 billion pesos. At the same time it wrote down "private bank reserves" by the same amount. This simple bookkeeping operation resulted in a decline of bank reserves from 2.6 billion pesos in May to 1.5 billion in June. However, in the following month, reserves jumped again to 2.1 billion.

The sudden rise represented a maneuver by which the Central Bank issued 1.4 billion pesos of Mortgage Bonds to the "private banks"--i.e., to itself. The operation was scarcely a step removed from the printing press. The Argentine government called in for redemption 1.5 billion pesos of publicly held 4 per cent National Mortgage Bonds. The Central Bank printed in their place 2 billion pesos of 2-1/2 per cent Central Bank Mortgage Bonds. Of the new issue, the public took only 600 million and the Central Bank--through its agent banks--took the rest. Of the 1.4 billion thus created, 900 million went out to the public in cash for redemption of the old, unconverted bonds, and the remaining 500 million went to the national government. The inflationary effect of launching 900 million into circulation was at once reflected in total deposits, which in the single month of July jumped 10 per cent (from 8.7 billion pesos to 9.5 billion).

In a very significant speech on November 15, 1946, to a meeting of provincial finance ministers, Perón stated that when he took office the government did not even have enough money to pay salaries for July. "Now, six months later," he said, "we have financed the 1946 and 1947 budgets without asking a cent from anyone."

The government, said Perón, has discovered and "plugged up" a "leak" in the national economy. He further stated that the leak thus plugged up will be used to finance the Five Year Plan without public bond issues or foreign loans or increased taxes. "The financial aspects of the Plan should not worry anyone," he said, "because if I promise not to contract foreign debts, nor internal loans, nor raise taxes, I believe that it is nobody's business where I obtain the money."

The real extent of the inflation will depend on Perón himself: how much he wants to spend, and how much of a risk he is willing to take. With the present acute shortage of materials and the soaring cost of living, the financing of large public works expenditures by the Central Bank for the so-called Five Year Plan will certainly add to the inflation in the country.