L.5.2
CONFIDENTIAL

RFD. 56

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

REVIEW OF FOREIGN DEVELOPMENTS

March 11, 1947

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.

Financial Developments in Austria

J. Herbert Furth

Two years after liberation, Austria still has probably the lowest standard of living of any European country outside the Soviet zone of influence. Repeated declarations of the United States that Austria was to be treated as a liberated rather than as an ex-enemy nation have so far had little practical effect. The country remains divided into four zones of occupation, and the agreement of June 28, 1946, which returned to the Austrian Government the bulk of the authority previously exercised by the Allied Council, has never been implemented in the Russian zone. The Russian authorities continue to treat the country's most valuable natural resources and industrial enterprises as German assets[1] and discourage any resistance by public officials or private owners by deportation to Siberia. The food ration for "normal consumers" remained at the starvation level of 1,200 calories until November 11, 1946, when it was finally raised to 1,550 calories, the level prevailing in Germany. Delay in concluding negotiations for American credits has depressed the morale of enterpreneurs and workers alike. The territorial and financial claims which Yugoslavia, with Russian support, presented to the Conference of Foreign Ministers threaten further economic losses. The record severity of this winter, coupled with the catastrophic lack of fuel and clothing, has made necessary rigid restrictions in industrial activity and transportation, and multiplied the misery of the people.

1/ See this Review, October 21, 1946, supplement.

Under these circumstances, it is surprising that the Austrian economy in 1946 made any progress at all. In spite of all handicaps, however, Austria has managed to proceed with the reconstruction of her economic system, due primarily to the help extended by UNRRA and by the American and British occupation authorities. She has substantially improved her financial position, and has preserved as much freedom of private enterprise as permitted by the occupying powers. Employment is at record levels: unemployment, the greatest scourge of the country during the inter-war period, in November 1946 stood at a mere 65,000, as compared to 369,000 at the end of 1937 and 84,000 in January 1946, and vacancies were 70 per cent larger than the number of job applications. On the other hand, ton-kilometers of freight carried by railroads were less than one-third as great as at the end of 1937; in the absence of an overall index of economic activity, this ratio is probably representative of average economic production. The discrepancy between employment and output is due to the lowered efficiency of labor, attributable mainly to the continuing poor level of nutrition, and also to the necessity of devoting much work to tasks of rehabilitation, such as removal of rubble, which do not appear in output statistics. Even so, the progress achieved in 1946 is striking: between January and November 1946, production of steel ingots rose from 8 to 47 per cent of 1937, and output of magnesite (one of the country's most important natural resources) from 2 to 55 per cent. Unless relief assistance is prematurely terminated or the forthcoming treaty with the Allied powers imposes intolerable conditions, the prospects for substantial recovery in 1947 are encouraging.

Currency and Banking. At the end of November 1946, note circulation amounted to 5,657 million schillings (565.7 million dollars at the official rate of exchange), of which about half (2,792 million) was paid to the occupying powers as occupation costs. In the eight months following the end of the conversion of German marks into the reestablished Austrian currency,[1] note circulation increased by 1,451 million schillings, of which 812 million went to the occupying powers. Largely offsetting this rise, free deposits with the National Bank decreased by 1,244 million, to 2,898 million schillings. Blocked deposits, representing mainly the equivalent of notes "frozen" in connection with the currency conversion, amounted to 4,015 million. The cover of these liabilities consisted almost exclusively of claims of the National Bank against the Austrian Treasury since all tangible assets of the Bank were carried off by the Germans after the annexation in 1938. Gold and foreign exchange reserves were only 17 million schillings, but meanwhile have been increased by around 47.5 million in gold returned to the Bank by the American occupation authorities as the first installment of the gold reserves recaptured from the Germans. Further and more substantial restitution deliveries are expected from the distribution of the German "gold pot".

At the end of November 1946, financial institutions (excluding the National Bank) had demand deposits of 4,111 million schillings, savings deposits of 3,473 million, and blocked deposits of 8,425 million. Fragmentary figures for previous dates indicate slight but steady withdrawals of deposits during the year. All means of payment (notes and free deposits) totalled 16,139 million schillings, as compared with 4,025 million at the end of 1937;

1/ See this Review, July 15, 1946, p. 4.

the increase was proportionately far larger in currency (455 per cent), deposits with the National Bank (832 per cent), and demand deposits with other institutions (722 per cent) than in savings deposits (58 per cent). Because of the devaluation of the Austrian currency, the increase in means of payment in terms of dollars was only around 117 per cent; if the black-market rate of the dollar is used for computing the 1946 value of means of payment in circulation, a drop of 69 per cent is indicated. All these developments reflect the familiar influence of war finance and its aftermath on European countries.

The foreign exchange value of the schilling was fixed by the National Bank at the former "military rate" of 10 schillings per dollar, as compared to around 5.40 schillings in 1938. In the black market, the price of the dollar dropped from 165 schillings in January to 70 in December. The official gold price, based upon the dollar parity, was 11-1/4 schillings per gram of fine gold. In the black market, the price (computed on the quotations for commercial gold, 7/12th fine) dropped from the equivalent of around 515 schillings per gram of fine gold in January to around 78 schillings in December, and at the latter date corresponded exactly to the black-market dollar rate.

The domestic purchasing power of the currency was very high in terms of official prices, and very low in terms of black-market prices. The official cost-of-living index reached 158 per cent of 1938 in November 1946, but in view of the devaluation of the Austrian currency this meant a level, in terms of dollars, of only 85 per cent of 1938. At the time, the cost-of-living index in the United States stood at around 152 per cent of 1938. On the basis of legal prices, the purchasing parity of the Austrian currency would thus approximate the pre-war rather than the newly established exchange rate.

Actually, however, such commodities as were available, apart from the meager official rations, were traded at prices which were from ten to one hundred times as high as the legal quotations. Between January and December 1946, these extra-legal prices decreased substantially, particularly for goods which reached the black market through offerings from Allied troops and gift parcels from the United States. Flour dropped from 45 to 25 schillings per kilogram, lard from 400 to 120 schillings per kilogram, cigarettes from 5 to 1.20 schillings apiece, and chocolate from 900 to 20 schillings per bar. As far as the available data permit comparisons, these extra-legal prices are about twice as high as prices in the United States if schillings are converted into dollars at the black-market rate. On this basis, the Austrian currency would be overvalued in relation to the dollar even at the black market rate. Under these conditions it is impossible to determine the actual domestic purchasing power and thus the prospective equilibrium exchange rate of the Austrian currency at the present time.1/

Wages have moved approximately in proportion to legal prices: in September 1946, weekly net earnings averaged 140 per cent of August 1938 earnings. These wages were ample for purchasing the official rations and making payments for rent and other necessary services at the legal prices, but gave wage-earners little opportunity to supplement their rations with additional purchases. Average weekly earnings in Vienna varied from 41 schillings for unskilled female labor to 62 schillings for skilled male labor;

1/ For a discussion of a similar problem in the case of Germany, see this Review, January 14, 1947, p. 14.

even the latter figure represented the black market price of just one pound of lard. This discrepancy impaired both the supply and the efficiency of labor in a manner familiar to all observers of economic life in post-war Europe.

Public Finance. Budget estimates for 1946[1] included expenditures for ordinary government activities of 1,705 million schillings, for extraordinary activities (mainly repair of war damage, but excluding all costs of occupation) of 181 million, and for the net deficit of all state monopolies and enterprises (including railroads) of 185 million, making a total of 2,071 million schillings. In the estimates for 1947, expenditures for normal activities were raised to 1,893 million, for extraordinary activities to 285 million, and for the deficit of state enterprises to 348 million (mainly because of an increase in reconstruction expenditures), making a total of 2,526 million schillings, or 455 million more than for 1946. In comparison, total expenditures in 1937 were 1,454 million schillings, of which 264 million were for defense and investments (thus roughly comparable to the extraordinary expenditures in 1946 and 1947), and 117 million for the deficit of state enterprises. The increase in expenditures thus has remained very small in comparison with the changes suffered by government expenditures in most other countries.

Government revenues were estimated at 1,741 million schillings for 1946, and 1,999 million for 1947, as compared to 1,383 million in 1937. The deficit was thus estimated at 330 million for 1946 and 527 million for 1947, as compared to 71 million schillings in 1937. In the post-war period, about one-third of all revenues has been derived from income taxation and almost the same portion from the tax on tobacco. In 1937, however, income taxes accounted for only one-fifth, and the revenue from tobacco for only one-eighth of total revenues while sales and excise taxes played a more prominent role than in recent years. Receipts from customs duties, which amounted to 208 million schillings in 1937, have become negligible because of the catastrophic decline in foreign trade.

The estimates of government expenditures are unrealistic because of the exclusion of occupation costs. That part of these costs that consisted of cash payments to the occupying powers amounted to 1,500 million schillings for the period from liberation to January 12, 1946, and to 1,292.5 million for the period from January 13, 1946 to the end of that year. In addition, an estimated 250 million schillings was spent on compensation for occupation payments in kind (requisitions and services) in 1946. Total occupation costs were thus equal to around three-fourths of all budget expenditures of the government of that year. For 1947, this burden will be considerably smaller. Cash payments have been set at 130 million schillings for the first quarter, and probably will not exceed 450 million for the entire year. The sum will be further cut if the treaty with the Allied powers is signed in time for the occupation forces to be withdrawn before the end of the year. Compensation for payments in kind also will be reduced since at least the American and British occupation authorities have promised to discontinue requisitioning. Another easing of the burden of occupation was attempted in the fall of 1946 when the Western powers

---

1/ The presentation differs from official figures, which include all receipts and expenditures of state enterprises and part of the occupation costs. The change is made for the sake of comparing the figures with those for 1947 and 1938.

decided to pay their troops in scrip, good only for purchases in military establishments, rather than in Austrian currency. In this way, the payments cannot be used for purchasing civilian goods and cutting the supply available to the native population.

No figures showing actual receipts and expenditures have been published since liberation. If reality conforms to the budget estimates, the financial situation of the government is encouraging. It is true that expenditures are bound to increase since government salaries cannot be kept at the present low level without grave danger to the efficiency and honesty of the civil service. On the other hand, receipts will rise considerably with the return of more normal business conditions. A large part of extraordinary expenditures will be met out of the sale of relief goods, which netted more than 450 million schillings in 1946. All receipts from the sale of goods given to the government by UNRRA or to be delivered in the future through American and British relief grants have been earmarked for the repair of war damage.

The fate of the Austrian public debt is still uncertain. Service of the foreign debt, outstanding in the equivalent of 780 million schillings (78 million dollars) and requiring a yearly service of 54 million schillings, has been temporarily suspended with the consent of the occupying powers. The Austrian Government has included in its budget the amount of the annual payments (in domestic currency) as well as an additional 96 million schillings for the service of the internal debt. The latter sum would represent the annual charges on a capital sum of around 1,500 million schillings, approximating the pre-annexation amount of the Austrian domestic debt, which was converted into German reich bonds in 1938. There remains the question of another 6,500 million schillings in German reich bonds held by Austrian investors. The government probably will be compelled to take over at least part of that indebtedness in view of the importance of such bond holdings in the balance sheets of all Austrian financial institutions,1/ but the burden of these payments, which would be 400 million schillings annually if met in full, may be substantially lightened by a combination of the conversion with a capital levy.

<u>International Finance</u>. In the summer and fall of 1946, the Allied Council gradually restored the control of foreign trade to the Austrian Government, and Austrian statistics now show detailed foreign trade figures. The data continue to be fragmentary, however, because they exclude relief and military shipments. Moreover, it is reported that deliveries over the borders of the Russian zone are still frequently withheld from inspection by the Austrian authorities. This accounts for the startling fact that the statistics do not report any exports to the Soviet Union although it is known that Russia is importing large quantities of Austrian oil from her zone of occupation.

Austria continues to experience great difficulties in financing her foreign trade. Most of the country's foreign exchange reserves were removed by the Germans after the annexation in 1938, and further losses were suffered during and after the struggle for liberation. The country was thus completely devoid of means to purchase the capital goods and raw materials necessary for reconstructing the productive apparatus destroyed by the war and its aftermath.

1/ See this <u>Review</u>, July 15, 1946, p. 4.

Even a credit of 10 million dollars granted by the United States for the purchase of army surplus remained largely unused because Austria did not possess the foreign exchange needed to pay costs of shipping the surplus material from its depot to Austria. Slowly some kind of barter trade developed, but commerce was hampered by the fact that all trade agreements had to be approved by the Allied Council and that the Austrian Government did not receive the right to police the country's border until November 1946.

Another difficulty was presented by the discrepancy between the domestic and the world market price levels. World market prices are so much higher than official domestic prices that it would be impossible to sell imported goods at the legal price level on the domestic market. On the other hand, world market prices are so much lower than black market domestic prices that it would be more profitable to sell exportable goods on the black market than abroad even if the receipts in the foreign exchange could be converted into schillings at the black-market rate. In order to overcome at least the first of these obstacles, the Austrian Government at the end of the year established an Equalization Office, the function of which will be to help Austrian importers to adjust their purchase and sales prices.

The value data included in Austrian foreign trade statistics are somewhat misleading since most commodities are valued, according to barter agreements, on some arbitrary base, e.g., official pre-war prices. Imports from January through November 1946 were 2,195,400 metric tons valued at 223 million schillings (22.3 million dollars at the official rate of exchange), and exports 499,800 tons valued at 189 million schillings (18.9 million dollars). The corresponding data for 1937 (eleven-twelfths of the yearly totals) were imports of 5,664,800 metric tons valued at 1,339 million schillings (248 million dollars at the 1937 rate of exchange) and exports of 3,491,400 tons valued at 1,128 million schillings (209 million dollars). Even if it is considered that the 1946 dollar figures should at least be doubled in order to make them comparable with the 1937 data, it is clear that foreign trade averaged not more than one-fifth of the pre-war level. The relatively larger quantity of imports is due to the weight of coal shipments which represented in 1946 about 85 per cent but in 1937 only 55 per cent of the volume of all imports.

Austria's most important trading partners in the first eleven months of 1946 were Switzerland (imports: 69 million schillings; exports: 70 million), Czechoslovakia (38 million and 36 million, respectively), Germany (56 million and 4 million), Italy (18 million and 35 million), the United States (8 million and 13 million), France (5 million and 8 million), and Hungary (7 million and 4 million). The startling similarity in the import and export trade with various countries shows the influence of bilateral trade agreements. Yugoslavia, Rumania, the United Kingdom, and Poland, each of which in 1937 had foreign trade with Austria totalling from 120 to 180 million schillings, had little share in the 1946 trade.

Austrian imports included, in addition to coal, mainly textile fibers, machinery, chemicals, and tobacco; exports were primarily of lumber, magnesite, textiles, paper, ceramics, glassware, iron goods, and chemical products.

Relief imports were substantially larger than commercial imports, but their exact amount cannot be computed because complete data on military and private shipments are not available. The largest single item consisted of 101.5 million dollars worth of UNRRA shipments. During the first quarter, before UNRRA started operations in Austria, American army supplies played an important role. Payment for coal shipments from the British zone of occupation in Germany, which reached 2.1 million tons in the entire year, have been temporarily deferred.

Altogether, relief and credit shipments (including the utilized part of an American army-surplus credit and considerable private relief assistance) probably reached 135 million dollars in 1946. For 1947, Austria has been assured of 36 million dollars of undelivered UNRRA shipments, and 40 million dollars of British relief grants and credits. Applications for similar American assistance are pending. It is hoped that Austrian exports will reach or even surpass the 100 million dollar level.1/ If this expectation is realized, Austria could finance an import program of around 300 million dollars, which would be necessary for rehabilitating the country's economy and banishing the specter of starvation which has haunted the country ever since liberation. With the negotiation of a treaty with the Allied powers and the end of occupation in prospect, reconstruction probably will proceed more rapidly than before, and it is to be expected that 1947 will be the last year in which Austria's survival will depend upon foreign charity.

1/ See this Review, November 18, 1946, p. 1.

Value and Pattern of Poland's Foreign Trade in 1946

Hans J. Dernburg

Official estimates of Poland's balance of trade, which have recently become available, may be presented in the following condensed statement:

Poland's Balance of Trade in 1946
(In millions of dollars)

Exports			Imports		
Under trade agreements			Under trade agreements		
Soviet Union	58.6		Soviet Union	90.7	
Sweden	25.5		Sweden	19.8	
Germany - Eastern Zone	7.4		Germany - Eastern Zone	7.8	
Other countries1/	30.1	121.6	Other countries1/	7.5	125.8
Outside trade agreements		3.3	Outside trade agreements		2.4
Coal deliveries to Soviet Union under reparations agreement		57.0	Reparations from Germany		19.6
			UNRRA deliveries		270.6
			U.S. surplus property		31.0
		181.9			449.4

1/ The countries are Austria, Belgium, Bulgaria, Denmark, Finland, France, Hungary, Italy, Norway, Rumania, Switzerland, and Yugoslavia.

It would appear from these figures that Poland had a trade deficit of 267.5 million dollars. However, of Poland's total imports of 449 million dollars, no payment was required for goods valued at 290.2 million dollars, consisting of 270.6 million dollars of UNRRA deliveries and of 19.6 million dollars of reparation deliveries from Germany. Moreover, imports of United States surplus property to the value of 31 million dollars were financed out of the 50 million dollar credit from the Office of the Foreign Liquidation Commissioner.1/ Excluding these items, imports requiring payment in cash or compensation in goods amounted to only 128 million dollars. These items were approximately balanced by 125 million dollars of exports under or outside of Poland's trade agreements.

In addition to these exports, Polish statistics list 57 million dollars of coal exports to the Soviet Union. This item represents 5.7 million tons of coal delivered to Russia under a special agreement attached to the reparation settlement. For this coal the Poles are receiving only a token price rumored to be as low as 80 cents per ton; the importance of these exports as a means of payment for imports is therefore extremely small. The Poles, however, value this coal in their statistics at 10 dollars a ton, the average price at which coal is being exported under the various trade agreements. Although this procedure considerably overstates the agreed valuation of the coal delivered on reparations account, the method may have been chosen by the Poles in order to reveal their actual export capacity and to show their trade with the Soviet Union in more realistic proportions. It will be noted that Poland's trade with the Soviet Union under trade agreements resulted in an excess of imports over exports of about 32 million dollars; including the coal exports as valued in the statistics, the Polish data would indicate an excess of exports over imports amounting to nearly 25 million dollars.

A comparison of Poland's foreign trade in 1938 and in 1946 is given in the table on the following page. Values for 1946 have been converted into 1938 values by using the ratio 166:100 employed by the Poles in recent foreign trade comparisons.2/

Poland's exports in 1938 amounted to 223.6 million dollars and in 1946 to 182 million dollars, including the coal exports to the Soviet Union valued at 57 million dollars. Adjusted for price increases, exports in 1946 would be valued in 1938 prices at 109 million dollars and would represent about 49 per cent of exports in 1938. Excluding coal deliveries to the Soviet Union, total exports (at adjusted values) would amount to 75 million dollars, equivalent to about 33 per cent of the exports in 1938.

Poland's imports in 1938 amounted to 245 million dollars and those in 1946 to 450 million dollars, the latter figure including UNRRA imports of 271 million dollars. In terms of 1938 prices total imports in 1946 would have amounted to 270 million dollars, equivalent to about 110 per cent of 1938 imports

---

1/ By the end of 1946, imports under the 40 million dollar Export-Import Bank credit had not yet begun, although orders had been placed and certain advance payments had been made.

2/ This index is probably based on the American wholesale price index which in January 1946 stood at 136 and in December at 179 (1938=100).

Excluding UNRRA imports, adjusted imports in 1946 would be valued at 107 million dollars, equivalent to 44 per cent of the 1938 level. UNRRA imports represented 60 per cent of total imports in 1946.

Poland: Total Exports and Imports by Groups of Countries, 1938 and 1946

	Exports			Imports			Exports		Imports	
	1938	1946	1946 at 1938 prices 1/	1938	1946	1946 at 1938 prices 1/	1938	1946	1938	1946
	(In millions of dollars)						(In per cent of total)			
Soviet Union 2/	1.4	115.6 3/	69.4	2.6	90.7	54.4	.6	63.5	1.1	20.2
Other Eastern countries 4/	15.0	7.8	4.7	17.3	3.6	2.2	6.7	4.3	7.0	.8
Total	16.4	123.4	74.1	19.9	94.3	56.6	7.3	67.8	8.1	21.0
Germany and Austria	53.9	8.9 5/	5.3	56.5	27.9 5/6/	16.7	24.1	4.9	23.0	6.2
Western countries (excluding U.S.)	141.4	49.5	29.7	138.9	129.5 7/	77.7	63.2	27.2	56.6	28.8
United States	11.9	.2	.1	29.9	197.8 8/	118.6	5.3	.1	12.2	44.0
Total	223.6	182.0	109.2	245.2	449.5	269.6	100.0	100.0	100.0	100.0

1/ Adjusted under the assumption made in Polish statistics that values of 1946 are 66 per cent above values of 1938 (see text, p. 8).
2/ Including the Baltic States.
3/ Including 57 million dollars for coal deliveries under reparations agreement (see text, p. 8).
4/ Including Bulgaria, Czechoslovakia, Finland, Hungary, Rumania, and Yugoslavia.
5/ Trade under agreements with Austria and the Russian zone of occupation in Germany.
6/ Including 19.6 million in reparations from Germany.
7/ Including 104.7 million dollars of UNRRA deliveries.
8/ Including 165.9 million dollars of UNRRA deliveries, 31.0 million dollars of deliveries of surplus property, and .9 million dollars of other imports from the United States.

Great changes have occurred in the pattern of Polish trade. In 1938, 69 per cent of her exports went to "Western countries" (of which 5 per cent to the United States), 24 per cent to Germany (including Austria), and only 7 per cent to the Soviet Union, the Baltic States, and countries now under Russian influence. In 1946, however, "Western countries" accounted for only 27 per cent, and Germany (Eastern zone) and Austria for 5 per cent, while the Soviet Union and other countries under her influence accounted for 68 per cent of Polish exports. On the basis of constant prices, trade with "Eastern countries" (including reparation coal) rose to 284 per cent of 1938. If deliveries of reparation coal are excluded, the share of the "Eastern countries" declines to 53 per cent and that of the "Western countries" (including the United States) increases to 40 per cent.

In 1938, over two-thirds of Poland's imports came from "Western countries" (including 12 per cent from the United States), 23 per cent from Germany (including Austria), and only 8 per cent from the Soviet Union, the Baltic States, and countries now under Russian influence. In 1946, on the other hand, 73 per cent of total imports were derived from "Western countries" (including the United States with 44 per cent), of which 60 per cent were UNRRA deliveries; 21 per cent came from "Eastern countries"; and 6.2 per cent from Germany and Austria. Excluding UNRRA deliveries, the share of the "Eastern countries" represented 53 per cent and that of the Western group 32 per cent of total imports.

Of special interest is the changed pattern of Poland's coal exports. The Eastern group took two-thirds of total Polish coal exports in 1946 against 10 per cent in 1938, the Western group took 29 per cent against 70 per cent in 1938. In 1946 the Soviet Union received 61 per cent of Polish coal exports, and Sweden, which in 1938 was the largest importer of coal, received 15 per cent. The share of the various groups of countries in 1938 and in 1946 is given in the table below.

Poland: Exports of Coal and Coke by Groups of Countries
1938 and 1946

Country of destination	1938	1946	1946 at 1938 prices 1/	1938	1946
	(In millions of dollars)			(In per cent)	
Soviet Union 2/	.4	88.6 4/	62.0	.8	61.2
Other Eastern countries 3/	3.7	7.2	5.0	8.8	4.9
Total	4.1	95.8	67.0	9.6	66.1
Germany and Austria	4.2	7.8 5/	5.5	9.7	5.3
Western countries	29.9	41.2	28.9	69.6	28.5
Provisioning of foreign ships	4.7	--	--	11.1	--
Total	42.9	144.8	101.4	100.0	100.0

1/ The price of coal in 1938 was about 7 dollars as compared with 10 dollars in 1946.

2/ Including Estonia, Latvia, and Lithuania.

3/ Group includes Bulgaria, Czechoslovakia, Finland, Hungary, Rumania, and Yugoslavia.

4/ Including 5.7 million tons delivered to the Soviet Union under reparations agreement. Here, as in official Polish statements, the coal is valued at 10 dollars per ton, though a considerably lower price was received.

5/ Trade under agreements with Austria and the Russian zone of occupation in Germany.

Exchange Control in Italy

A. O. Hirschman

On January 27, an agreement between the American and Italian governments established a new rate of exchange for United States Government expenditures in Italy. This rate is intended to provide American military and civilian personnel with approximately the same amount of lire per dollar as is obtained by Italian exporters earning dollar exchange. Since March 1946, Italian exporters have had to surrender only 50 per cent of their hard foreign exchange proceeds to the Italian exchange control agency at the official rate (225 lire to the dollar);1/ they obtained the right to dispose freely, at whatever price the market might set, of the other half provided that it was used within a specified time-limit for the import of certain commodities. Supposing a "free export rate" of 425 to the dollar, the exporter would therefore obtain .5 x 225 + .5 x 425 = 375 lire for each dollar earned through exports. In order to give similar advantages to United States Government personnel in Italy, the rate of 225 will be averaged on the 25th of each month with the average free export rate for the preceding 30 days. The resulting rate will be applicable during the following month to United States Government expenditures. It amounted to 378 lire per dollar for February.

Simultaneously with the announcement of this monetary agreement, an Italian decree extended the benefit of the so-called "50 per cent system" to all non-commercial transactions (including tourists' expenditures, remittances, and investments) with all hard-currency countries. This will generalize the awkward cross-rates which have been prevailing on the free export exchange market where the Swiss franc has normally been quoted higher, and the pound sterling lower, than their official rates to the dollar.

The complicated, if ingenious, system which has been devised, while actually extending the "50 per cent system" from commercial to all foreign receipts, has been interpreted as the beginning of the end of the Italian experiment in multiple rates and limited freedom of foreign exchange. Ever since the fall of 1946, government officials and the financial press have forecast, discussed, advocated, or bemoaned its impending abolition to be carried out through the establishment of just such an average rate as has now been set for United States Government expenditures. This seems a proper moment, therefore, to review and appraise the "50 per cent system".

Freedom for exporters to retain part of their foreign exchange proceeds as a means of stimulating exports was urged by the First National Meeting of Foreign Traders at Milan in March 1946. The demand was quickly met by two decrees, dated March 15 and April 13, 1946, which authorized exporters to utilize or sell 50 per cent of their "free" currency proceeds (i.e., excluding currencies of countries with which payments agreements were in force) within 90 days. For this purpose foreign exchange accounts were to be opened at authorized banks; to the second decree was appended a list A of commodities which could be imported simply upon proof of the availability of free foreign

1/ Cf. this Review, June 3, 1946. Nominally, the official rate still stands at 100 lire to the dollar and is raised to 225 by a so-called "equalization quota" of 125 per cent which is uniformly applicable to all official foreign exchange transactions.

exchange and list B of commodities the importation of which required in addition a regular license. The system got rapidly underway, possibly as a result of the experience which Italian industrialists, particularly in the textile field, had gained with a very similar system during the immediate pre-war years.[1] Since May 1946 "free export rates" for the United States dollar, the British pound, and the Swiss franc have been regularly quoted by the financial press.

The system, as established in March/April 1946, went through two distinct phases. The first was one of extension and liberalization, the second one of gradual restriction. The first phase, which lasted through August 1946, was marked by an extension of the time limit to a maximum of four months (Decree of May 31, 1946); and by admission to the benefits of the system of proceeds from repairs of foreign ships and of freight receipts (August 1946).

Soon thereafter, on September 3, 1946, the first restrictive measures were taken. These were intended mainly to prevent unduly slow turnover of the foreign exchange controlled privately under the system. The time limit within which utilization is mandatory was cut down to 60 days and a general limit of 120 days starting from the moment of acquisition of foreign exchange was set for the actual physical importation of the goods purchased. The most important further restriction was the shift, ordered on September 26, 1946, of cotton and wool from list A of freely importable commodities to the regime of ministerial license applicable to commodities on list B. The reason for this step was probably that the Italian textile industry was then already at or near capacity and that the authorities intended to check an excessive building-up of raw material inventories.

Finally, in October 1946, the 50 per cent system was largely abolished insofar as manufacturing for foreign account was concerned. This practice, particularly important in the textile industry, consists in importing raw materials from a foreign firm which keeps title to the material as it is being transformed into finished goods specified by and deliverable to that firm. In this way the Italian manufacturer has no initial outlay for raw materials and is paid only for "value added". The restrictive legislation adopted in October allowed the exporter the benefits of the 50 per cent system when value added exceeded the value of the foreign raw material used.

The table on the following page shows the development of the exchange rate for "free export" dollars and pounds sterling compared with black market rates for bank notes and with wholesale prices and the cost of living. While at first the bank note rate was inferior to the export rate, the opposite relationship has prevailed since the middle of November 1946. The export rate has not experienced the violent fluctuations of the black market quotations which brought the value of the dollar note to a maximum quotation of 755 on December 3. These latter fluctuations were caused by sudden and variously

---

1/ Between 1937 and 1939 from 50 to 75 per cent of foreign exchange earnings were left to various classes of exporters of manufactured products. The economic implications of this policy were excellently analyzed by G. Demaria, "I rapporti di cambio manovrato in regime di autarchia corporativa," Giornale degli Economisti LIII (1938), 1-16, and by G. Boggio, "Contingentamenti e cambi specifici," Rivista Italiana di Scienze Economiche, XI (1939), 970-996.

motivated flights from the lira in a thinning market while no such elements acted on the export rate. The sharp rise of the export rate until September seems to have been in anticipation of the rise of the price level during the later months of the year. Soon after a temporary leveling-off of prices during the early part of 1946 it was indeed generally felt that the de facto devaluation of 125 per cent which had taken place in January had not been sufficient, that demands for wage increases could not be held back and that Treasury Minister Corbino's "orthodox" financial policy was doomed to failure. Furthermore, the peace treaty negotiations on which Italian public attention was then focused led to a general pessimistic feeling about Italy's economic future. Since September the export rate for dollars has displayed remarkable stability which may be explained partly by the impact of rising prices in the United States, and partly by the restrictive legislation mentioned above. The measures adopted eliminated or reduced certain classes of demand for the export currencies while leaving the supply relatively unaffected.

	Dollar		Pound Sterling		Wholesale Prices 1/		Cost of Living (1938=100) 2/
	Export rate	Bank note	Export rate	Bank note	Official	Black market	
Jan. 1946	-	382	-	1,119	2,305 3/	4,633 3/	3,096
May "	364	333	1,446	920	2,289	4,588	2,899
June "	377	366	1,593	1,057	2,314	4,429	2,823
July "	478	401	1,864	1,222	2,351	4,430	2,811
Aug. "	505	483	1,847	1,369	2,573	4,683	2,898
Sept. "	596	530	1,965	1,464	2,665	4,838	2,677
Oct. "	601	520	1,957	1,448	2,805	5,108	2,935
Nov. "	569	600	1,651	1,690	2,953	5,502	3,037
Dec. "	565	679	1,516	1,869	3,179	6,599	3,295
Jan. 23, 1947	533	605	1,587	1,700			

1/ Indexes calculated by the Societa Edison; both indexes include prevailing free market prices of unregulated commodities.
2/ Index of "cost of subsistance for middle classes" calculated by the Centro per la Statistica Aziendale.
3/ Index for February 1946; January index not available.

In attempting to appraise the Italian experiment in limited freedom of foreign exchanges, it should first be pointed out that the emergence of the experiment was greatly favored by the almost total absence of efficient State controls at the moment Italy recovered her sovereignty in matters of foreign trade from the Allied Commission on January 31, 1946. Furthermore, the UNRRA program guaranteed the most essential imports for the whole of 1946 and thereby reduced the risks inherent in the decision to leave allocation of half of the foreign exchange earned by exporters to competitive forces. These two conditions have now come, or are about to come, to an end and this alone makes the survival of the 50 per cent system precarious. But both friends and foes of the system agree that it has given Italian exports a powerful fillip during 1946. Its immediate effect was to transfer excess profits from importers (where they generally accrue in exchange control systems) to exporters, a shift which is certainly welcome when a country is struggling with foreign exchange difficulties. As a result of competitive bidding on the part of importers, exporters disposed of their foreign exchange at very advantageous prices. This actually stimulated exports to the extent of diverting many essential goods, particularly textiles, from home consumption and thereby increasing prices in certain sectors of the economy. An increase in the general price level, however, should result from this process only to the extent that the system permitted the creation of a foreign exchange reserve in the hands of exporters (which could easily be taken over by the State should it decide to abolish the "50 per cent system") or the necessary rebuilding of raw material inventories.

According to data supplied by the Association of Italian Joint-Stock Companies (Italian Economic Survey, December 1946, p. 14), foreign exchange proceeds from exports not yet utilized amounted at the end of November 1946 to 14.9 million dollars, 7.5 million pounds sterling, 1.9 million Swiss francs, and smaller amounts of other free currencies. It is understood that in December there was a further substantial increase in these figures. The relatively large amount of sterling holdings results from the difficulties of acquiring freely importable (List A) commodities in the sterling area and this fact may also account for the gradual but steady deterioration of the sterling cross rate relative to the dollar evident from the table on page 11. While on the black market for bank notes the pound has consistently been valued somewhat below three dollars, the export currency market reflected during the first two months approximately the official cross rate; only in November did the value of the pound fall below three dollars.

On the whole, the "50 per cent system" seems to have contributed greatly to Italian economic recovery in the past year; it has made Italian producers definitely export-conscious and has resulted in the allocation of certain imports according to efficiency of the producers rather than by reference to some fictitious base period or simply by favoritism. It has made underbilling of exports with the intent of accumulating foreign exchange abroad much less attractive than under conditions of strict exchange control. Finally, it has oriented Italian export trade toward the hard currency countries, a welcome development since the deficit of Italy's balance of payments is primarily a hard currency and even a dollar deficit. Bresciani-Turroni, in an article published by the Corriere della Sera in Milan (January 16, 1947) has advocated the continuance of the system because of its proven elasticity and adaptability to cost and price changes, which in the present unsettled state of the Italian economy are inevitable and even desirable.

According to unofficial preliminary estimates for 1946 now coming from Rome, Italy's exports have made an excellent showing by reaching the level of 350-400 million dollars of which 230 million went to free-currency countries. Thus Italy bids fair to be the country for which the universal underestimate of exports during 1946 in balance-of-payments forecasts is highest, on a percentage basis. Indeed various forecasts had put the exports for 1946 at

125 to 175 million dollars, that is, at 25 per cent to 50 per cent of the actual result.1/

In spite of its indubitable contributions to Italy's economic recovery, the "50 per cent system" seems definitely in jeopardy. Among its enemies are the Italian bureaucrats and "total planners" to whom any kind of economic freedom is anathema. They have valuable allies in the countries with which Italy has clearing agreements. These countries have to pay the official exchange rate (225 lire to a dollar) for their imports from Italy while importers in free-currency countries take advantage of the export rate. This has led to the temptation for clearing-agreement countries to use some of their free-exchange resources in their trade with Italy, as Sweden has recently done in order to acquire some Italian manufactures of special value for the Swedish economy. Italian proponents of the "50 per cent system" have thus been able to claim that the 50 per cent system has not only freed Italian trade from the shackles of exchange control, but has also contributed to the expansion of the free zone of multilaterally conducted international trade generally (Sole, January 24, 1947).

The incentive for Italian exporters to direct their sales to free-currency countries and the reluctance of importers in exchange-agreement countries to buy Italian goods at the official rate of exchange has led to a reversal of the Italian position on clearing accounts from a creditor to a debtor status.2/ Poland, in particular, has recently complained about Italian prices being far too high if converted at the official rate rather than the free export rate.

Further pressure for abolition of the "50 per cent system" is exerted by the British, mainly because of the unfavorable dollar-pound cross rate which has prevailed in the Italian exchange markets. Furthermore, some Italian newspapers have intimated that the ranks of the enemies of the 50 per cent system are due to be swollen by the International Monetary Fund, of which Italy is soon to become a member. The I.M.F. is, of course, opposed in principle to multiple exchange rates, but it seems unlikely that in this particular instance the Fund would press for immediate abolition. In view of high priority import requirements, there can be no question of leaving to the exporters 100 per cent of the foreign exchange earned. Reestablishment of a unique rate at the present

---

1/ Other European controlled economics are discovering the advantages of giving exporters the incentive of relatively free disposition of some portion of their foreign exchange earnings. Thus, France has recently made a timid step in the direction of Italy's system by allowing exporters of textiles and automotive products to retain 10 per cent of their exchange earnings for the purchase of industrial equipment. In Spain, exporters have been permitted since August 30, 1946, to retain one-third of their export proceeds for imports of raw materials, provided that one-fourth of the exchange delivered to the Exchange Control authorities (i.e., one-sixth of the total) is in free foreign exchange. In neither France nor Spain do exporters have the possibility of selling the retained exchange to importers.

2/ This reversal is partly due to prepayments by Italian importers who, acting on the basis of rumors of impending devaluation, hastened to settle all their commitments at the present rate. As a result, payments by importers were limited in January 1947 to 200,000 lire; payments in excess of this amount had to be authorized by the Italian Exchange Control Agency.

time, therefore, could only mean reversion to the obligation for exporters to surrender all foreign exchange to the authorities. Such a development would clearly run counter to one of the main purposes of the Fund, which is to assist member countries in the relaxation and eventual removal of exchange controls. While it is true that even a nation's currency system cannot indefinitely remain "half slave and half free", it would appear better to leave it provisionally in this condition pending the creation of the bases for a system of total freedom--when the only practical alternative is a return to total regulation. If it is desired to keep the essential features of the present system while removing from it the stigma of multiplicity of exchange rates, this can easily be done by adopting the device--familiar in South America--of letting the exporter sell to the importer not the foreign exchange itself, but the right to buy foreign exchange which is then acquired at the official exchange rate from the monetary authorities.

Opponents of the system have pointed out that Italian exports would not suffer if, as they propose, the new single rate is set half-way between the official and the export rate, so that the lira proceeds of the Italian exporter would remain unchanged. To this it is easy to reply (1) that this might be true for the moment the rate is set, but that subsequent cost, price, and demand changes could soon make exports very unattractive--or excessively profitable; (2) that exporters value not only the high lira proceeds they obtain for 50 per cent of their foreign exchange, but also, and quite importantly, the very right of relatively free disposition over this amount: i.e., the freedom from administrative control, the freedom to utilize the exchange themselves if they should so desire, the goodwill derived from ceding it to some supplier, etc.

Finally, the question might be asked: Supposing that a single rate has to be set, does the free export rate provide an indication as to the probable level of the equilibrium rate? Official utterances and articles in the press have frequently given the impression that the equilibrium rate necessarily lies half-way between the official rate and the export rate. This, of course, would hold true only under very special conditions of demand which are highly unlikely to obtain. Nevertheless, it is certain that the level and movements of the free export rate provide incomparably more valuable indications as to the probable equilibrium level of the lira, than do black market quotations for bank notes, fluctuations of which have been largely determined by psychological factors and resulting capital movements.1/ The present system permits the monetary authorities to gauge the intensity of specific demands for foreign exchange at prevailing international prices through the device of adding to or subtracting from the list A of commodities which can be freely acquired abroad with the exporters' free exchange, thereby increasing or decreasing the number of bidders in the free export exchange market. Gradual addition of even more commodities to the free list, coupled with a concomitant increase in the supply of free exchange through successive raising of the percentage of foreign exchange earnings retained by exporters, might actually be one answer to the baffling problem of how to achieve conditions of relative monetary freedom in an orderly fashion and without undue exchange rate fluctuations.

1/ It so happens that purchasing power parity calculations based on cost-of-living indexes for November/December 1946 and taking 1938 as the base year yield a parity quite close to the average between the official and free export rates.

It is the conclusion of this article, therefore, that the abolition of the "50 per cent system" at the present time is undesirable since it would:

(1) increase the area of restriction in Italian and international trade and finance;

(2) have unfavorable effects upon Italy's exports and balance of payments; and

(3) deprive the Italian authorities of a valuable signpost and of a possible method for attaining a new equilibrium of exchange rates in a system of freer international payments.

United States Exports in 1946

C.R.H. and G.H.F.

Although the total value of recorded exports, including reexports, from the United States in 1946, at 9,738 million dollars, differed very slightly from the value of 1945 exports (9,806 million dollars), large and varied shifts occurred in the commodity composition and in the country distribution of those exports. The more substantial of these shifts are shown in the appended tables I and II. Detailed analysis of these data will not be attempted at this time, but a few general comments may be in order.

With the values of exports in 1945 taken as 100, the value index for exports in 1946 by economic classes is as follows:

Shift in Commodity Composition of United States Exports in 1946 1/

	Value index (1945=100)	Increase (+) or decrease (-) from 1945 (Millions of dollars)
Crude materials	160	+540
Crude foodstuffs	150	+217
Manufactured foodstuffs	122	+278
Semimanufactures	114	+112
Manufactures	80	-1,235

The decline in the value of manufactures resulted primarily from the cessation of shipments of munitions, 2/ which amounted to nearly 2 billion dollars in 1945. Substantial declines were also recorded in this class for exports of trucks and busses and of gasoline, while increases occurred in exports of machinery, textiles, passenger automobiles, merchant vessels, and many other products.

1/ These data refer to exports of United States merchandise only.

2/ Included in this category during the war years were aircraft, explosives, firearms, tanks, etc.

Increased exports were recorded for all economic classes other than finished manufactures, with crude materials and crude foodstuffs showing the greatest percentage increase. Cotton, coal, and tobacco accounted for most of the rise in the crude materials class. According to the Department of Commerce index of the unit values of exports for this class, the average of monthly prices during 1946 was about 112 per cent of the 1945 average. On the basis of these data the volume increase in crude material exports between 1945 and 1946 may be estimated at about 43 per cent.

In the field of foodstuffs, both crude and manufactured, wheat and wheat flour played predominant roles in raising the value of United States exports. Although wheat prices have advanced rapidly in recent months, the weighted average value per bushel of wheat shipped in 1946 was only about 12 per cent above that of 1945, while wheat flour prices averaged 19 per cent higher. Exports of meat and dairy products increased substantially during 1946 as deliveries for cash and on UNRRA account more than offset the rapid decline in lend-lease shipments of these relatively expensive foods. Substantial quantities of these goods (prepared and packaged for export) became available as a result of cutbacks in the requirements of the armed forces during the year; it is doubtful that shipments in 1947 will be maintained at the 1946 level. Exports of semi-finished manufactures increased moderately, the greatest gain, of 69 million dollars, occurring in the "all other" classification not further differentiated in the statistics released to date. Coal tar products, leather, sawed timber, pigments and semimanufactures of iron and steel and of aluminum showed moderate gains while fuel oil, semi-finished products of brass and bronze and industrial chemicals declined.

The shifts in distribution of United States exports, shown in Table II, may also be summarized by use of a value index.

Shift in Geographic Distribution of United States Exports in 1946

	Value index (1945=100)	Increase (+) or decrease (-) from 1945 (Millions of dollars)
South America	178	+507
Asia	159	+498
North America	131	+602
Africa	93	-36
Europe	75	-1,395
Australia and Oceania	33	-230

Shipments to the United Kingdom and the U.S.S.R. declined by 2.8 billion dollars, reflecting in large part the drop in lend-lease exports. Exports to the rest of Europe, however, increased from 1.5 billion dollars in 1945 to 2.9 billion dollars in 1946 to offset half of the fall in exports to England and the Soviet Union. The substantial decline in exports to Australia and Oceania may be explained both by the decline in lend-lease aid to the area and by attempts of Australia and New Zealand to re-divert purchases to pre-war sources of supply.

Trade with eastern Asia in 1945 consisted primarily of transactions with India and Ceylon. In 1946, exports to these countries dropped sharply while shipments to China, the Philippine Islands, and other Far Eastern countries (excluding Japan) rose well above pre-war levels. Recorded exports to Japan in 1946 were valued at 102 million dollars (approximately 40 per cent of the average annual value for 1936-38) while imports from that country reached 110 million dollars.

The 1946 increase in exports to South American countries is not surprising in view of the inability of these countries to purchase to the full extent of their cash resources and material needs during the war years. Although the value of United States exports to the area in 1946 was more than four times the average value in 1936-38, United States imports from South America, at 1.1 billion dollars in 1946, were nearly equal to the value of exports.

The 600 million dollar increase in shipments to North American countries, on the other hand, coincided with a decline of more than 250 million dollars in United States imports from this area. Exports to Canada in 1946 were only fractionally lower in value than in the peak war years, while United States imports from Canada were 30 per cent below the record level of 1944. Mexico increased its purchases from this country in 1946 by almost 200 million dollars while exporting no more to the United States than in the preceding year. On the basis of United States statistics, the 1946 debit balance of Canada on trade account vis-a-vis this country appears to be around 550 million dollars and that of Mexico around 270 million dollars. It is doubtful that either country will permit such unbalanced trade positions to be continued indefinitely.

Table I

Exports of United States Merchandise by Commodity Classification
(In millions of dollars)

	Calendar year 1946		Increase (+) or decrease (-) from 1945	
Exports of United States merchandise	9,500		-89	
Crude Materials	1,414		+540	
Cotton, unmanufactured		536		258
Coal		302		118
Tobacco, unmanufactured		352		113
"All other" crude materials 1/		150		36
Manufactured Foodstuffs	1,524		+278	
Wheat flour		219		129
Dairy products		296		60
Meat products		341		52
"All other" manufactured foodstuffs 1/		154		36
Milled rice		60		26
Dried eggs		124		62
Crude Foodstuffs	648		+217	
Wheat		391		151
"All other" crude foodstuffs 1/		94		50
Semimanufactures	894		+112	
"All other" semimanufactures 1/		288		69
Coal tar products		63		28
Finished Manufactures	5,019		-1,235	
Industrial machinery		842		136
Cotton manufactures		355		132
Passenger cars (new)		123		121
Merchant vessels		117		82
Rayon, nylon, etc.		127		72
Tobacco manufactures		63		44
Iron and steel advanced manufactures		156		41
Lubricating oil		115		34
Medicinal and pharm. prep.		145		29
Office appliances		51		28
Auto. parts for replacement		87		-57
Engines for aircraft		12		-114
Motor trucks and busses (new)		231		-122
Motor fuel and gasoline		105		-360
Airplanes (landplanes and seaplanes; powered and without engines)		65		-598
"All other" finished manufactures 1/		1,236		-715

1/ "All other" refers to unspecified residual in the source material supplied by the Department of Commerce; in the abbreviated tables presented here, it does not refer to entire residual for the class.

Table II

United States Exports and Reexports by Geographic Areas
(In millions of dollars)

	Calendar year 1946		Increase (+) or decrease (-) from 1945	
Exports, including reexports	9,738		-68	
North America	2,544		+602	
Canada		1,442		263
Mexico		505		196
Cuba		272		76
South America	1,152		+507	
Argentina		193		154
Brazil		356		138
Venezuela		212		75
Colombia		146		58
Asia	1,343		+498	
China		466		374
Philippine Islands		297		255
Japan		102		101
Netherlands Indies		73		52
Hong Kong		47		44
Ceylon		10		-76
India and Dependencies		181		-310
Africa	488		-36	
Union of South Africa		227		96
Algeria		61		-30
Egypt		35		-130
Australia and Oceania	117		-240	
Australia		84		-230
Europe	4,098		-1,395	
France		712		240
Sweden		206		160
Belgium and Luxembourg		279		144
Netherlands		222		140
Italy		371		140
Poland and Danzig		183		99
Germany		82		80
Norway		79		60
Czechoslovakia		107		55
Greece		143		50
Austria		46		46
Switzerland		108		45
Yugoslavia		128		37
Portugal		60		37
Denmark and Faroe Islands		38		33
Finland		31		30
United Kingdom		856		-1,334
U.S.S.R. (Russia)		358		-1,481