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RFD. 68

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

REVIEW OF FOREIGN DEVELOPMENTS

August 26, 1947

FISCAL POLICY AND INCENTIVES IN GREAT BRITAIN

Robert A. Rennie

The greater degree of austerity which Prime Minister Attlee's economic program will impose upon Great Britain raises new problems of incentives. After eight years of sacrifices, the people have again been asked to produce more and to consume less. Patriotic motivation scarcely can be as compelling now as during the war, and the physical and emotional fatigue is more intense. In these circumstances, the high money wages and the accumulation of war savings not only tend to conceal from the people the gravity of the national problem but also act as deterrents to greater effort.

The British economy is characterized by a condition of "suppressed inflation", which has best been described by the expression "£7 billion of money chasing after £6 billion worth of goods". Throughout the war, there was a margin between the wages of a British laborer and the value of the goods he could buy in the controlled market. The inflationary gap resulted from the allotment of approximately 50 per cent of current production to war use. In a free economy, this gap would have tended to disappear as the competitive bidding for scarce goods raised prices, but in the United Kingdom price controls and rationing together with government subsidies prevented commodity prices from climbing.

The result is, of course, accumulation of more or less involuntary savings. As long as the war continued the sacrifice involved was readily accepted as a patriotic duty. At present, however, it is possible to induce the public in Great Britain to continue to work in return for promises of deferred consumption only as long as they are reasonably certain those promises will be kept. Many holders of accumulated savings, far from desiring to add to their stock of liquid assets, wish to spend them for consumption goods at the earliest opportunity.

Moreover, as savings accumulate, the individual will equate the diminishing marginal utility of further saving with the marginal disutility of labor effort. The result will be a weakening in the incentive to work. In the absence of strong compulsions, there will be a gradual withdrawal of marginal workers from the market and a decline of marginal labor effort in the form of overtime. Since current income is adequate to buy available rationed goods and since the stock of savings is sufficient to provide for foreseeable emergencies, the small increase in earnings attainable through overtime work or through employment in the essential but less agreeable coal and engineering industries provide inadequate incentive for additional effort or a shift in employment. The high level of absenteeism in the coal industry can be explained partly in these general terms.

Very limited success has been attained by the Government's recent drive to induce the public to increase its saving. The National Savings Movement, which is designed to stimulate investment in savings certificates and defense bonds and to foster the growth of savings deposits, has produced a net total of only £55.4 million in the first 17 weeks of the current fiscal year, whereas the target rate for that period was £119 million. Although there is an increasing tendency to hold cash, there has also been a rise in purchases of unrationed goods not subject to price control. Food and tobacco prices rose 4.7 per cent in the second quarter of 1947,-the principal increases being reflected in the uncontrolled sectors. The increase in the propensity to spend has also appeared in the substantial rise in vacation expenditures this year.

The excessive pressure to spend liquid assets aggravates directly the balance of payments problem by exerting a continuous demand for larger imports. Its results were clearly reflected in the rise in tobacco purchases and film remittances during 1946. Yet, as Chancellor Dalton admitted in his speech of August 7, any direct measures to restrict imports or to expand exports would increase the total purchasing power as compared with the total goods available in the home market. Thus additional controls in the home market would be needed lest inflationary pressures be intensified.

There are other disadvantages arising from the excess of purchasing power over the total of goods available in a controlled economy. Professor J. R. Hicks has revealed1/ how demand pressing on supply tends to deplete the economy of its reserve stocks of goods and raw materials. In a system of price-fixing without strict rationing of demand, nothing prevents the exhaustion of inventories and the supply pipelines. Such an "empty" economy is particularly subject to accidents such as the coal crisis the repercussions of which ramify throughout the system and virtually bring all industry to an abrupt halt. This condition enhances the bargaining power of special groups such as labor in particular industries, but inevitably results in low productivity and a low standard of living for the public in general.

1/ Hicks, John R., "The Empty Economy", Lloyds Bank Review, July 1947, pp. 1-13. Cf. also Hawtrey, R. G., Economic Destiny, pp. 246-7.

Various measures could be taken to check the excess demand, several of which were touched upon in Mr. Dalton's address. There could be a change in budgetary policy designed to increase the revenue surplus either by increased taxation or by reduced expenditures. At the present time, tax revenues only slightly exceed the expenditures arising from government sources. Chancellor Dalton reported that, abstracting various debatable items, there was a net surplus of £21 million in the ordinary government accounts in the first four months of the current fiscal year. Such a surplus can be considered negligible as a means of reducing inflationary pressures.

In the present circumstances, however, it would be very difficult to increase the surplus. British taxes are already at levels which produce serious adverse effects upon incentives. The income tax rate is more than twice as high as that imposed in the United States on incomes up to $5,000. On the other hand, it does not appear possible to reduce expenditures substantially. As a result, adjustments of the budget in the narrower sense are not likely to provide an adequate solution to the problem of surplus purchasing power.

To relieve the inflationary pressures, the Government can resort to broader fiscal measures. It has frequently been pointed out in Great Britain that the Government's program of capital development such as building and plant modernization was too ambitious in the light of what could be afforded. Expenditures for capital reconstruction not only pump additional purchasing power into the economy, but use scarce materials and manpower urgently needed for the production of export commodities. Chancellor Dalton has promised to revise the time schedule of capital undertakings in order to give higher priorities to such industries as coal and agriculture. To implement this shift in resources, annual timber imports have been cut by £10 million. As desirable as capital development projects may be in the long run, it was a case of attempting too much too soon.

Leading economists outside official circles have called for a temporary abandonment of the official "cheap money" low interest rate policy. While recognizing the long-term advantages of the Government's position, they have indicated that higher rates would reduce the quantity of funds currently available for spending on capital account. In addition, it would tend to increase the proportion of capital financed by the banks, which could then exert a greater measure of qualitative control.

In his speech of August 7, the Chancellor of the Exchequer also called for an intensification of the National Savings Campaign to mop up some of the surplus earnings. The success of this policy will depend upon the Government's ability to reëngender the wartime spirit of sacrifice among all sectors of the nation.

More drastic methods to extinguish the redundant money have been advanced by Mr. R. G. Hawtrey and Professor J. R. Hicks. Mr. Hawtrey would assess forced loans directly on a given proportion of the bank deposits, currency, and other liquid assets held by the public. Professor Hicks' proposal is very similar, except that the compulsory loan would be assessed on all capital assets. Such general application of the forced loan would raise serious problems of valuation not present in the Hawtrey proposal. Both plans would force the abandonment of the Government's cheap money policy in order to prevent the replacement of frozen liquid assets by new bank credit.

The wholesale deflation envisaged by these plans might be very difficult to manage. If carried too far, anti-inflationary measures could produce unemployment in the midst of a scarcity of goods. Furthermore, the recent experience of other countries indicates that forced loans may have widely varying incidence upon different groups within the economy. If adopted in the United Kingdom, it might be advisable to apply such restriction in gradual stages, for no simple criterion can be relied upon to guide fiscal and credit policy.

But strong anti-inflationary policy is imperative. Inflationary pressures have become a major deterrent to production. Increase in output is necessary not only to provide the goods from which larger exports can be drawn, but also to replace the imports the country no longer can afford. Without such policies, it is doubtful if Britain can attain equilibrium in its international position at a sustained level of income for its population.

AUSTRIA'S COAL IMPORTS -- A CASE STUDY IN POSTWAR INTERNATIONAL ECONOMIC ARRANGEMENTS

J. Herbert Furth

Austrian industry is based upon imported coal. In 1937, coal imports amounted to 3.3 million metric tons; that year's level of economic activity did not create full employment but may be considered a satisfactory goal for the immediate postwar period. Imported coal furnished 32 per cent of all caloric energy, the remainder being supplied by water power (30 per cent), domestically produced coal (21 per cent), wood (13 per cent), and oil products (4 per cent). The main sources of supply were Czechoslovakia (43 per cent of all imports), Poland (26 per cent), Germany (24 per cent), and Hungary (4 per cent). Imports are particularly significant for Austria because domestic mines produce almost exclusively brown coal so that the hard coal (Steinkohle) and coking coal has to be shipped from abroad.

In 1946, Austria produced domestically 1.55 million tons of hard coal equivalent[1] and imported 2.25 million. In the first five months of 1947, domestic production rose to an annual rate of 1.85 million tons (85 per cent of the 1937 level), but imports dropped to an annual rate of 1.95 million (less than 60 per cent of 1937). This decline was the main reason for the setback in the rehabilitation of Austria in the spring of 1947. For technical reasons, domestic coal production cannot be expected to rise substantially above the present level. Austria's water power is capable of

1/ In this paper, the hard coal equivalent of brown coal is computed at 1 ton of brown coal equal to 0.6 ton of hard coal, corresponding to the ratio of 4,200 calories per ton of brown coal to 7,000 calories per ton of hard coal (Austrian Institute for Economic Research: Energy Basis of the Austrian Economy, Vienna, 1946, p. 4). This ratio differs from that used in other statistics which for simplicity's sake often take 1 ton of brown coal as equal to 0.5 ton of hard coal.

great expansion, but the necessary investments are costly and will yield an increased output only after some time. The supply of wood is strictly limited by the condition of Austria's war-depleted forests. Domestic oil supplies have been greatly developed, but the Soviet occupation authorities that control them at present, allocate only 40 per cent of the output to Austrian consumption.

Austria's prospects of more rapid recovery thus depend upon an increase in coal imports. Europe suffers from a general coal famine, mainly because of the decline in the production of the German and British mines. Until recently, Austria could offer to coal-exporting countries neither important commodities nor free foreign exchange, and thus it received hardly any coal except for shipments from the Ruhr mines, payment for which was deferred by the U.K. occupation authorities in Germany. In June 1947, however, the situation was changed considerably, thanks mainly to the assistance granted to Austria under the post-UNRRA relief program of the United States, and to a series of multilateral trade arrangements negotiated by the Austrian authorities. The coal program for the third quarter of 1947, made possible by these arrangements, is summarized in the following table.

Austria's Coal Imports, Third Quarter 1947
(Hard coal equivalent, monthly average)

Source	Amount (Thousands of metric tons)	Average price (Dollars per ton)	Total value (Thousands of dollars)	Method of payment
U.K. zone of Germany	150	11	1,650	About 40,000 tons by compensation with power exports, remainder in dollars.
Poland	95	17	1,615	20,000 tons by exports, 20,000 tons by agreement with Sweden, remainder in dollars.
United States	30	25	750	In dollars.
Czechoslovakia	10	24	240	By agreement with Italy.
Hungary and Yugoslavia	10	17	170	By exports.
Total	295	15	4,425	

Minimum coal imports needed by the Austrian economy have been calculated at 3.18 million tons of hard coal equivalent per year[1] or 265,000 tons per month. This is somewhat less than the 1937 level of imports, but 60 per cent higher than the average imports during the first five months of 1947.

About 150,000 tons per month are shipped to Austria from the U.K. zone of Germany.[2] These shipments require a monthly expenditure of $1.65 million,[3] of which about $450,000 is covered by Austrian exports of electric power to Germany and the remainder of $1.2 million has to be paid in dollars. These coal deliveries are slightly below the 1946 average, but almost 30 per cent higher than the average shipments in the first five months of 1947.

The deliveries are expected to be increased by 15,000 tons per month under an agreement that has been under discussion for some time. That additional quantity would have to be shipped to the fertilizer plant at Linz (Upper Austria), in exchange for fertilizer to be supplied by that plant to the U.S.-U.K. zones of Germany. The agreement has been delayed by some difference of opinion as to the form in which payment should be made for that portion of the fertilizer shipments which would not be covered by the delivery of coal.

About 95,000 tons per month come from Poland, which now includes the former German coal mines of Upper Silesia. Under a trade agreement of June 3, 1947, Poland ships to Austria 50,000 tons at an average price of $17 per ton, whereby 20,000 tons are to be compensated for by Austrian exports (mainly iron goods and machinery), and 30,000 tons have to be paid for in dollars (total cost: $510,000). In addition, in the five months from May through September 1947, Austria is receiving an average of 20,000 tons per month under an agreement concluded by Austria with Sweden and by Sweden with Poland. The coal is going to the blast furnace at Linz and is being used for making pig iron, rolled wire, iron sheets, and steel plates for Sweden. Payment is made directly from Sweden to Poland. Finally, Austria counts upon receiving another 25,000 tons per month from Poland to be paid for in dollars (total cost: $425,000), Poland being eager to sell its coal for free foreign exchange. Polish coal deliveries averaged only 13,000 tons per month in 1946, and 82,500 tons in the first five months of 1947.

The United States is scheduled to become the third important source of coal although American coal normally would not be able to compete in Europe with European coal. Austria has been allocated a quota of 30,000 tons per month, reportedly at the price of $25 per ton (total cost: $750,000). No American coal was sent to Austria in 1946 or the first five months of 1947.

1/ Excluding about 150,000 tons needed for transit traffic and supplied to the Austrian railroads by agreements with coal-producing neighbors.

2/ The allotment includes around 130,000 tons of hard coal and 45,000 tons of hard coal equivalent in the form of brown coal briquets; of the total of about 175,000 tons, around 25,000 tons are earmarked for the use of the occupation forces in Austria.

3/ Assuming that the threatened rise in the price of Ruhr coal from $11 to $17 per ton does not materialize. All prices are c.i.f. Austrian border.

Czechoslovakia is to ship around 10,000 tons of coke per month under an agreement concluded in July 1947 among Austria, Italy, and Czechoslovakia. The coke is to go to the blast furnace at Donawitz (Styria), and to be used for making steel for ship construction for Italy. Payment is to be made directly from Italy to Czechoslovakia, at a reported price of $24 per ton. This arrangement is similar to the agreement between Austria, Sweden, and Poland. Austria also is said to be negotiating for 5,000 tons of hard coal equivalent from Czechoslovakia on a bilateral basis.

Other coal shipments totaling a hard coal equivalent of 10,000 tons per month are covered by trade agreements with Hungary and Yugoslavia. Such a quantity would be about equal to prewar imports from these sources; it would be larger than the 1946 average, but somewhat smaller than the average in the first five months of 1947. In terms of hard coal equivalents, the average price appears to be about the same as that of Polish coal although the quality is said to be poorer.

Austria has been offered shipment of a total of 100,000 tons of hard coal equivalent in the form of brown coal briquets by the Soviet Union, to be delivered from German coal mines located in the USSR zone. The price is so high, however (about $25 per ton of hard coal equivalent), as to make the acceptance of the offer very doubtful.

Disregarding the hoped-for increases in German and Czechoslovak shipments and the Soviet offer, monthly coal imports thus will total 295,000 tons. This seems to be 30,000 tons more than the calculated minimum needs; actually, however, the excess is far smaller since the calculated minimum does not include the quantities that must be used for the trilateral deals with Sweden-Poland (20,000 tons) and Italy-Czechoslovakia (10,000 tons).

About 100,000 tons per month are to be financed from exports of electric power or commodities, either bilaterally or trilaterally. The remaining 195,000 tons have to be paid for in free foreign exchange, at a total cost of $2,875,000 per month. For the second semester of 1947, the amount required thus would reach around $17,250,000. Austria will pay $11.3 million out of its share in the post-UNRRA relief program of the United States, and the remainder out of the refund of the occupation costs of the U.S. forces in Austria, which is expected to exceed $1 million per month.

The peculiarities of the postwar situation appear not only in the complicated arrangements needed to secure the financing of the imports, but also in the wide discrepancies in price. Some of these discrepancies are due to differences in quality, but a gap like that between $11 per ton for Ruhr coal and $25 per ton for American coal shows a serious deterioration in the working of the international price mechanism. The situation is far worse than even during the 'thirties when, despite widespread government interference with the forces of a free market, a price differential of around $1 per ton sufficed, for instance, to exclude the Ruhr in favor of Czechoslovakia and Silesia from the Austrian coal market.

For the remainder of the current year, the coal worries of Austria appear to be over. This optimism has to be qualified insofar as Austria's ability to fulfill its obligations under the bi- and tri-lateral trade arrangements might not be beyond doubt. These arrangements (excluding the export of electric power to Germany) make necessary monthly deliveries averaging about $1.1 million, or about one-third of the average volume of all Austrian exports in the first quarter of 1947. Since the most important enterprises engaged in these export deals, however, are located in the Western zones of Austria, there will be at least no political interference with the execution of the contracts.

The problem of continuing the import program through 1948 is more serious. The trilateral arrangements with Sweden-Poland and Italy-Czechoslovakia expire in September and December 1947, respectively, and the trade agreement with Poland expires in July 1948. Moreover, by that time the U.S. grant will be exhausted. It is possible, however, that by 1948 the coal program will have stimulated Austria's industrial production and export trade so successfully that Austria will be able to pay for its coal imports exclusively by means of its current foreign exchange earnings.

As a stop-gap arrangement, the conclusion of the coal negotiations was in any case a remarkable achievement. The integration of the foreign trade of Austria, Sweden, Italy, Poland, and Czechoslovakia with the aid granted to Austria by the United States is a decisive departure from the bilateral pattern that still rules European trade relations. The fact that two of the nations involved are outside of the group of "Marshall countries", shows both the need for, and the possibility of, extending economic cooperation to that part of Europe that is not yet ready for political collaboration with the West.

TRADE AND CREDIT ARRANGEMENTS BETWEEN THE "MARSHALL PLAN COUNTRIES"

A. O. Hirschman and M. J. Roberts

In general, the trade of European countries is conducted within the framework of bilateral payments or clearing agreements. Many of these agreements provide for the opening of reciprocal credits which generally take the form of holding the trading partner's currency up to certain limits. These credits make possible departure of trade (and other current payments) from strict bilateral balancing. In addition, certain of the "Marshall Plan countries" have extended unilateral credits to other countries of the group for financing trade balances. It is the purpose of this paper to give a rough indication of the over-all role these credits have played in financing bilateral trade deficits among the "Marshall Plan countries."

While the available data on trade conducted by these countries in 1946 are subject to serious margins of error,[1] information on credits extended within or outside of payments agreements is still more uncertain. Even if precise and up-to-date information were available a comparison of the credits with the data on trade would encounter the following difficulties:

1. The credit arrangements usually are not made at the beginning of the year and their duration differs widely. Data on utilizations are not always available.

1/ See this *Review*, August 12, 1947.

2. The credits should be compared to the balance on current account (i.e., including current invisible items) rather than to the trade balance only.

3. In the case of the United Kingdom, credits extended generally were available for covering balances with the sterling area as a whole, so that the combined trade of the sterling area countries should be taken into account. Similarly, credits granted by and to France and other colonial powers related to transactions with the respective currency areas.

In this attempt at comparing the trade and credit figures, the following procedure has been followed:

1. In general, only credits that were granted between October 1, 1945, and September 30, 1946, were taken into account.

2. Whenever it appeared that the credit margin was higher than the trade balance or whenever there was provision for limitless holdings of the currency of the trading partner, it was assumed that the trade balance was fully covered by credit facilities.

Special difficulties were encountered in collecting and assessing the information on the credit arrangements made by the United Kingdom and for this reason as well as because of the great quantitative importance of British trade, the trade of the group is presented both with and without the United Kingdom.

In analyzing the statistical data, it was found that a misleading figure would be obtained by simply comparing the sum of mutual credits to the sum of bilateral trade balances. We are indeed in the presence of a distinctly U-shaped distribution; i.e., there are many bilateral relationships where no provision for credit existed at all, many other bilateral relationships where the provision for credits entirely covered the trade balance, and only a few relationships where there was some, but insufficient coverage. For this reason the information presented in the following tabulation is arranged according to the degree of coverage of the trade balances by credit facilities. The information pertains to 13 countries including the United Kingdom, i.e., to all the "Marshall Plan countries", excluding only Eire and Iceland.1/

The main feature brought out by the table is the utter lack of uniformity of the existing credit arrangements with respect to the coverage of the trade balances. The three categories of trade relationships shown are quite distinct. Each will be commented on briefly.

Trade between approximately half of the possible combinations of pairs of countries proceeded apparently without any credit facilities. True, this corresponded to a flow of only 20 to 25 per cent of total trade, but it may well be that this trade could have been materially expanded had credit margins been available.

1/ Trade with Germany has been excluded.

Trade and Credit Arrangements between the "Marshall Plan Countries" in 1946

Coverage of Trade Balance by Credits	Number of Pairs of Trading Countries[a]	Total Trade	Trade Balances: Total	Trade Balances: of which covered by credits
		(In millions of dollars)		
Including the United Kingdom				
None	39	770	185	0
Partial	13	1,641	726	348
Full	26	1,434	210	210
	78	3,845	1,121	558
Excluding the United Kingdom				
None	35	453	116	0
Partial	8	503	141	73
Full	23	1,081	160	160
	66	2,037	417	233

a/ The number of combinations of two elements from a total of 13 or 12 amounts to 78 and 66, respectively.

One-third of the possible combinations of pairs of countries had their trade balances fully covered by credit arrangements. Trade between these countries amounted to about 37 per cent of total trade including the United Kingdom, and to 53 per cent excluding the United Kingdom. On the whole, the trade of these countries appeared to be remarkably well balanced, total export or import surpluses amounting to only about 15 per cent of total trade, which is much lower than the corresponding percentages for the two other groups. It may seem paradoxical that the trade of the countries with the most generous credit margins should turn out to be the relatively best balanced. Could it be that it was precisely the ample availability of credit that produced a growth of trade which, in the end, led to greater balance than all the determined efforts at bilateral balance?

Finally, there are the countries the mutual trade of which shows an imbalance that is only partly covered by credit facilities. The number of trading pairs for which this is the case is quite small, but their trade, including the United Kingdom, amounts to almost 50 per cent of total trade. The United Kingdom accounts for the largest part of this trade, so that, when the United Kingdom is excluded from the group, the proportion of this type of trade in total trade falls to 25 per cent. The trade balances appear to be covered by credit facilities to the extent of 48 per cent when the United Kingdom is included, and to 52 per cent in the opposite case.

Altogether, $563 million worth of net balances appear not to have been covered by credit facilities in 1946. Excluding the United Kingdom, this figure is drastically reduced to $184 million. Insofar as these uncovered balances were not reduced by current invisible transactions, they can be presumed to have led:

1. to transfers of gold and foreign exchange or to pressure for such transfers on the part of the net exporting countries;

2. to pressure for increased credit facilities on the part of the net importing countries; and

3. to attempts at adjustment--more likely downward--of the flow of trade to the existing credit margins.

INCENTIVES FOR GERMAN EXPORTERS J.H.F.

The low level of German commercial exports has been a constant source of worry to the occupation authorities since it makes it impossible to increase imports except by means of grants or credits. Following similar measures adopted by the Soviet zone administration, the Joint Export-Import Agency of the combined U.S.-U.K. zones now has decided to make available to exporters 5 per cent of the foreign exchange resulting from export deliveries. Exporters can use that amount for importing raw materials or capital goods (in addition to those allocated to them by the authorities) or for defraying the cost of maintaining foreign representatives and promoting sales abroad. The amount reverts to the Agency unless it is spent within six months after it has become available. In addition, another 5 per cent of the foreign exchange proceeds is allocated to a "general account" which is to be used under the direction of the German bizonal administration for importing consumer goods for workers engaged in the production of export goods, thus giving them a personal incentive to increase output.

For the time being, the sums available to German exporters will be small. In July 1947, commercial export contracts amounted to $16 million, not counting sales of coal, timber, and services, which are not negotiated by private enterprises. On an annual rate, the sum at the disposal of German exporters thus would be less than $10 million. If, however, the volume of exports should rise to the amount planned under the bizonal agreement of 1946, the sum would reach eventually the neighborhood of $50 million annually. In that case, exporters would be able to exert considerable influence upon the development of the German economy.

Incentives of this kind are a corollary of the German system of price and foreign exchange control. Export prices are not permitted to exceed domestic prices in terms of marks, and even if they did, such differentials would be of little interest to producers because of the limited opportunities to spend, and the low propensity to hold, additional amounts of marks. The incentive is economical because presumably exporters know better than the control authorities what raw materials and capital goods their plants need most urgently. It presents opportunities for abuse, however, by permitting the use of foreign exchange to cover selling costs abroad. Exporters may negotiate collusive agreements with their foreign agents under which the foreigners, while officially being paid for alleged selling efforts, actually hold foreign exchange for the Germans. Exporters thus could accumulate foreign assets not subject to the control of the occupation authorities. This would enable them to evade in part the consequences of the expected radical currency reform and capital levy, and also would reduce the amount of foreign exchange available for necessary imports.

The bizonal authorities will have to take strong measures to prevent exporters from making such arrangements, and these measures in turn may complicate rather than simplify foreign trading procedures. It is intended to leave the details of regulation and execution to the German economic administration of the combined zones. This decision, justified on grounds of general policy and administrative expediency, will make necessary a double system of controls, namely, the control of exporters by the German administration and the equally important and difficult control of the German administration by the occupation authorities. Such complications, however, are unavoidable in the organization of an economy under foreign occupation, especially if some freedom of enterprise is to be injected into an essentially government-dominated system.

ECONOMIC AND FINANCIAL DEVELOPMENTS IN BULGARIA

C. B. Rose, Jr.

A Two Year Plan went into effect in Bulgaria on April 1, 1947. Its announced purpose is to expand the industrial and agricultural production of the country beyond prewar levels, and to raise the standard of living of the population. Certain aspects of the current Bulgarian financial and economic position are favorable to the achievement of this goal; other circumstances exist which raise doubts that the Plan[1] can be carried through, especially in the short space of two years.

Although Bulgaria experienced relatively little material war damage, shortages of consumer goods developed in consequence of the country's separation from normal sources of supply and the drain of meeting Germany's needs. The condition was aggravated after the war as a result of the depradations of the occupation army and continued isolation from world markets. Moreover, the food situation has become difficult following two years of drought. Normally a grain exporter, Bulgaria has been forced to import cereals as well as other foodstuffs. The price level has risen markedly although inflation to the extent which overtook some of the other countries of Southeastern Europe has been avoided. Indexes of industrial production indicate that although output remained far below prewar levels in some lines, the combined index averaged 15 per cent above 1939 in 1946. Total output, including agricultural as well as industrial, was only 86 per cent of 1939. The real income of the population, always among the lowest of Europe, has fallen in recent years. A small increase in 1946 compared with 1945 was not enough to lift it to prewar levels.

1/ A subsequent article in the Review will deal with the Plan.

National Income

Not only is the absolute level of Bulgarian national income low, but its distribution among the various elements of the population is very uneven. Recently published studies[1] place the total for 1946 (in current prices) at 334 billion leva. Real national income for that year, in 1939 prices, is given as 50.1 billion leva, or $440 million at the 1939 exchange rate (including the official premium). This amounted, in per capita terms, to $62.90 a year. Although approximately 80 per cent of the population are classed as rural, according to A. Kemilev this group received only 50 per cent of the total real national income, about half of which was in kind. For a major part of the population, then, income is barely sufficient to sustain minimum existence. This limits the tax base and leaves little scope for the State to draw off funds with which to finance a major capital investment program such as has been inaugurated. Kemilev, in the article referred to above, discussing this point, concludes: "The increase in the receipts of the State /in relation to national income/ indicates that the limit of tolerable taxation has been reached and that new possibilities for a substantial increase do not exist."

Public Finance and Money in Circulation

Little is known about the true budgetary position of the Bulgarian Government. Although both receipts and expenditures of the State are reported to have fallen in 1946 as compared with 1945, they were still--in nominal terms--substantially above prewar. No details are available on expenditures, but they totaled 75.4 billion leva, exceeding revenues by 6.8 billion. These figures are given as covering both ordinary and extraordinary budgets but not the accounts of the State railroads and port administration which ended the year with a small surplus.

During 1946, there was an increase of 6.0 billion leva in the outstanding volume of 3 per cent Treasury notes used as legal tender. The volume of bank notes outstanding, however, declined slightly as did total current accounts with the Bulgarian National Bank. The monthly average volume of money in circulation (Treasury certificates, bank notes, and coins) in 1946 was almost 16 times as much as the average in 1939. The pressure exerted upon prices by the swollen means of payment in the hands of the public was one of the factors behind a monetary reform undertaken in March 1947.

At that time, as part of the preparatory work for the Two Year Plan, an exchange of currency was executed. Only a small amount of the sums surrendered were exchanged in cash, the balance being put into blocked accounts. When these were released, on April 1, a limit was put on the amount of cash which any family might hold (40,000 leva) and the use of cash payments above 5,000 leva was prohibited. This not only made it easier for the State

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1/ "General Data on the National Income of Bulgaria for the period 1939-46", Monthly Bulletin of the Central Statistical Office, Nos. 2-3, February-March 1947; this revises figures given by Assen Kemilev, "Natsionalniiat Dokhod na Bilgaria" (National Income of Bulgaria), Narodno Stopanstvo, Vol. I, No. 1, November 1946, which also gave greater detail.

to mobilize bank resources to carry out the Plan, but facilitated the application of a capital levy upon nearly all forms of wealth. Collections are being made in six installments, the last one being due in November 1949.

The segment of the population which the capital levy will reach is limited. Possibilities of an increase in general tax receipts above the 1946 level (a year in which poor harvests adversely affected incomes and consequently government revenues, particularly from indirect taxation) are restricted by the considerations pointed out above.

Prices

Prices rose markedly during the war years to a level substantially above that of 1939. Since 1945, the rate of increase has tapered off somewhat, although the advance was relatively greater in 1946 than that of money in circulation. The cost of living rose less rapidly than wages. This, however, should not be taken as an indication of an improvement in the position of the urban consumer since the existence of a large black market is admitted, and it is probably true that many needs can be satisfied neither in markets where official prices prevail nor in the black market.

Available information on wages, moreover, covers industrial workers only. The income of salaried employees, especially civil servants, appears to have lagged behind the rise in prices which has been substantial enough seriously to affect the position of people living on fixed incomes and on savings. Disequilibria are evident in numerous sectors of the economy. Thus the formation of working capital has not kept pace with increases in raw material prices, and depreciation reserves are insufficient to replace inventories. There is maladjustment between the receipts from the sale of agricultural products and the net revenues of the farmers which deters the peasant from exploiting his full productive capacity. In some cases there is a discrepancy between prices and costs. Elimination of these strains must be accomplished before any price stabilization can be undertaken.1/

Foreign Trade

The decreased purchasing power of the lev has not been reflected in corresponding changes in official foreign exchange rates. In consequence, Bulgarian goods are handicapped in competition in world markets. Even in 1939, it was considered that the lev was overvalued in terms of foreign currencies despite the 35 per cent official premium then in existence. At the end of 1946, the index of export goods reached 861 (1939 = 100) while the rate of exchange for the dollar, for example, had risen only 160 per cent since 1939.2/

1/ Assen Kemilev: "Osnovite na Stopanskia Dvygodeshen Plan" (The Bases of the Two Year Plan), Narodno Stopanstvo, Vol. I, No. 4, February 1947.

2/ The official buying rate of the Bulgarian National Bank is \$1 = 285 leva, or a premium of 250 per cent over the prewar rate (including premium) of 113 leva = \$1.

This situation is reflected in the 1946 figures for Bulgarian exports, shown in the table below. The substantial increase in value is due solely to the rise in prices, while the volume of exports was only 43 per cent of prewar in 1945 and declined further in 1946 to one-third of 1939. The low level of exports was chiefly the result of the drought. While the volume of imports is also greatly below prewar, it showed a considerable recovery in 1946. Imports are vitally necessary to the reconstruction and expansion of the Bulgarian economy, but in the absence of a substantial increase in exports, the country's ability to pay for them will be greatly limited since other balance of payments items are of minor consequence. In the first four months of 1947, imports of 5,476 million leva exceeded exports by 429 million leva. Although it is too early for complete information on harvest results, it appears likely that Bulgaria will have to continue to import grain in the coming year. Equally serious is the likelihood that only limited quantities of agricultural produce will be available for export.

Foreign Trade

	1939	1945	1946
Imports			
In million leva	5,197.2	5,820.0	17,514.0
In per cent, 1939 = 100:			
Value	100.0	112.0	337.0
Volume a/	100.0	19.1	58.5
Price c.i.f. frontier	100.0	545.4	576.8
Quantity (tonnage)	100.0	43.6	123.3
Exports			
In million leva	6,064.8	12,232.8	14,942.0
In per cent, 1939 = 100:			
Value	100.0	201.6	246.4
Volume a/	100.0	43.2	33.5
Price f.o.b. frontier	100.0	472.9	735.2
Quantity (tonnage)	100.0	34.6	25.4

a/ At constant prices.

Since the war, an overwhelming proportion of Bulgaria's foreign trade has been with Russia. In 1945, the USSR supplied 80 per cent of the country's imports, and took 95 per cent of its exports. In 1946, the Soviet Union provided 82 per cent of the imports but took only 66 per cent of Bulgarian exports, Czechoslovakia taking 11 per cent. In the first four months of 1947, the importance of the USSR declined somewhat (imports 69 per cent and exports 45 per cent) while that of Czechoslovakia rose (imports 12 per cent, exports 22 per cent). No other single country was a significant trade partner. Should this concentration persist, it is questionable whether Bulgaria will be able to get the goods which it needs for reconstruction and expansion.

The recently concluded Bulgarian-Yugoslavian agreement on economic collaboration has been published only in general terms and it is impossible at present to estimate the benefits which may accrue from it. The most important feature is the relief afforded Bulgaria by the cancellation of Yugoslavia's reparation claims of $25 million. It is not known, however, what part of this obligation has been fulfilled.