L.5.2.
CONFIDENTIAL

RFD. 76

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

REVIEW OF FOREIGN DEVELOPMENTS

December 16, 1947

PROSPERITY, DEPRESSION, AND THE BRITISH PROBLEM

Randall Hinshaw

During the war, the view was widely expressed that the principal contribution which the United States could make toward a long-range solution of the British balance of payments problem would be to maintain a high level of domestic prosperity. It was argued that, under prosperous conditions, American imports of goods and services would be at a high level, and this would provide Britain with adequate markets for its exports, not only in the United States, but throughout the world. In an article1/ published two years ago, Lloyd A. Metzler and the present writer attempted to estimate the postwar British balance of payments under conditions of world prosperity. The conclusions of this article, which was concerned only with the post-transitional period, were moderately optimistic. Subject to certain qualifications, it was concluded that, in a prosperous world, British exports of goods and services would be at a level approximately sufficient to balance external accounts, including payment for the volume of imports demanded under prosperous conditions in Britain.

In recent months, a widely different view concerning the British problem has been given expression. According to this view, prosperity in the United States, instead of helping Britain, actually makes the British

1/ This article, entitled "World Prosperity and the British Balance of Payments", originally appeared in Current Comments for July 25, 1945. It was later published in revised form in the Review of Economic Statistics for November, 1945.

problem more intractable by increasing the cost of British imports. In fact, it has been suggested, more or less seriously, that a substantial depression in the United States would ease Britain's external difficulties by improving British terms of trade. While this appears to be an exaggerated view of the situation, the British balance of payments in recent months has taken such an unfavorable turn that it is well to re-examine the problem in the light of developments since the end of the war.

In Table I, the British balance of payments on current account for 1938 is compared with the balance for the third quarter of 1947. It can be seen from this table that the basic realities in the present British external position are (1) a heavily adverse balance of merchandise trade, (2) an abnormally high level of government expenditures abroad, and (3) a sharply reduced level of net income from overseas investments and other invisible sources. Those who hold that a depression in the United States

Table I

British Balance of Payments on Current Account

(Millions of Pounds Sterling)

	1938	Third Quarter 1947 (Annual Rate)
Payments		
Imports, c.i.f.	921	2,060
Less freight, etc.	86	320
Imports, f.o.b.	835	1,740
Government payments abroad	16	200
Total payments	851	1,940
Receipts		
Exports, f.o.b.	533	1,260
Investment income, net	175	75
Other net receipts	73	28
Total receipts	781	1,363
Balance on current account	-70	-577

would benefit the British position clearly are thinking largely in terms of the trade balance. With respect to (2), it is apparent that the high level of government payments abroad is a direct consequence of the war, and is only secondarily related to boom conditions in the United States, while, with respect to (3), it is obvious that a depression abroad would only make matters much worse than at present. Accordingly, we shall first center our attention on the trade balance in an effort to determine whether the adverse effect of world prosperity on the cost of British imports is likely to outweigh the favorable effect on net receipts from all sources.

British imports and exports, together with the balance of trade, are shown for selected periods in Table II. The quarterly figures are expressed at annual rates.

Table II

British Imports, Exports, and Trade Balance

(Millions of Pounds Sterling)

		Imports, c.i.f.	Exports, f.o.b.	Balance
1937		1,028	521	-507
1938		919	470	-449
1942		996	271	-725
1943		1,232	233	-999
1944		1,307	266	-1,041
1945 -	III	1,099	400	-699
	IV	939	482	-457
1946 -	I	1,118	740	-378
	II	1,270	890	-380
	III	1,314	958	-356
	IV	1,475	1,064	-411
1947 -	I	1,456	999	-457
	II	1,816	1,062	-754
	III	2,060	1,260	-800

In recent months, the rise in the British trade deficit has been of alarming proportions. The major factor explaining the mounting deficit is the rapid rise in world prices. In a situation, such as this, where imports are initially larger than exports, a given percentage increase in both import and export prices adds a larger absolute amount to the value of imports than to the value of exports. In these circumstances, a doubling of prices on both sides is a serious matter: it not only doubles the value of imports and exports; it also doubles the trade deficit. Actually, both import and export prices in Britain are well over twice the 1938 level and, of the two series, import prices have registered the greater increase. British import prices in the third quarter of 1947 were two-and-a-half times as high as in 1938, while British export prices were two-and-a-third times as high. To show how unfavorable these price developments have been, it may be pointed out that, at 1938 prices, the trade deficit for the third quarter of 1947 would have amounted to an annual rate of only £272 million instead of the actual figure of £800 million.

To a considerable degree, the rise in prices has occurred since the removal, in mid-1946, of price controls in the United States. British imports in the third quarter of 1947 were at an annual rate of £2,060 million (c.i.f.). At the import prices prevailing in June 1946, these imports would have cost only £1,650 million. At the same time, British exports, which in the third quarter of 1947 were at an annual rate of £1,260 million, would have been valued in June 1946 at £1,061 million. Thus, at the prices prevailing in June 1946, the trade deficit (as well as the deficit on current account) for the third quarter of 1947 would have been £211 million less than was actually the case. That is to say, more than a third (37 per cent) of the estimated deficit on current account for the third quarter of this year is attributable to unfavorable price developments since the middle of 1946.

Nevertheless, the thesis that a depression abroad would help Britain must be viewed with marked skepticism. A plausible case for this proposition can be made only by soft-pedaling some of the more important repercussions of a decline in foreign demand. While a depression would result in lower world prices, this would not necessarily help Britain if the volume of British exports were seriously affected. Consider, for example, the current trade deficit, which has been running at an annual rate of about £800 million. If a depression were to result in a 30 per cent reduction in both export and import prices, and if the volume of exports remained unchanged, the deficit would be reduced to £560 million. But the matter cannot be left here, since a depression abroad would result in a fall in the volume of British exports, even if, through appropriate domestic measures, Britain were able to maintain the volume of imports. In the depression of 1929, the volume of British exports fell by 37 per cent between 1929 and 1932. If, in the above case, a 30 per cent fall in prices were accompanied by a 30 per cent fall in the volume of exports, the British trade deficit would actually be larger than it is now (£825 million as against about £800 million). At the same time, net income from invisible sources would be considerably reduced, and the whole problem of achieving balance would be of much greater dimensions that at present.

In the light of recent developments, it is easy to be unduly pessimistic concerning future British prospects. In the article cited earlier, the authors made the following estimate of the post-transitional British balance of payments. This estimate was made on the assumption of

Table III

Estimated Post-Transitional British Balance of Payments Under Conditions of World Prosperity

(Millions of Pounds Sterling)

Payments	
Imports, c.i.f.	1,288
Less freight	188
Imports, f.o.b.	1,100 a/
Government payments abroad	64
Total payments	1,164
Receipts	
Exports, f.o.b.	795
Net invisible receipts	272
Total receipts	1,067
Balance on current account	-97

a/ As estimated in Metzler and Hinshaw, op. cit., minus freight as currently estimated.

prosperous conditions throughout the world. In some respects, it now appears over-optimistic. A much lower level of import and export prices than at present was assumed, as well as a much lower level of government expenditures abroad. However, it would be too early to conclude that net invisible receipts have been seriously overestimated. With the restoration of the British merchant fleet, with prospects of greatly increased receipts from tourist expenditures in Britain, and with further recovery in income from overseas investments, there is every reason to believe that net invisible receipts will gradually climb to a level much higher than at present. The article previously cited also assumed a volume of exports about 20 per cent above the level attained in the third quarter of 1947. Under conditions of adequate demand abroad, there is no reason to assume that this level cannot be reached. Indeed, present official export targets are much more ambitious than this; the immediate target calls for a volume of exports 37 per cent higher than the level attained in the third quarter of this year, while the target to be reached by the end of 1948 calls for a volume of exports 57 per cent higher.

Assuming (1) the present level of import and export prices, (2) a 20 per cent increase in the volume of exports, (3) a 50 per cent cut in government payments abroad,1/ and (4) the level of net invisible income estimated in the previously mentioned article, we get the following balance:

Table IV

Revised Estimate of Post-Transitional Balance of Payments Under Conditions of World Prosperity

(Millions of Pounds Sterling)

Payments	
Imports, c.i.f.	2,060
Less freight	320
Imports, f.o.b.	1,740
Government payments abroad	100
Total payments	1,840
Receipts	
Exports, f.o.b.	1,512
Net invisible receipts	272
Total receipts	1,784
Balance on current account	-56

The deficit on current account under these assumptions is only £56 million--a figure considerably smaller than the deficit for 1938. Assumptions only slightly more favorable would remove even this deficit. Indeed, if the present export program were successful in increasing export volume by 50 per cent—an increase substantially short of the goal for late 1948—the post-transitional deficit, under present assumptions, would be transformed into a surplus of £322 million. This would permit an 18 per cent increase in the volume of British imports. In any event, the moral would seem to be clear: Britain has more to gain from overseas prosperity than from overseas depression.

1/ This probably represents a conservative estimate of government payments in the post-transitional period.

ITALIAN EXCHANGE RATE POLICY

Albert O. Hirschman

The least that can be said about postwar Italian exchange rate and exchange control policies is that they have displayed remarkable inventiveness. Italy took the lead in providing various incentives to exporters and in permitting free markets in certain types of foreign exchange transactions.1/ The measures adopted on November 28 are only the latest development of this policy.

Characteristics of the Original Fifty Per Cent System

The Italian Government had hardly regained sovereignty over the regulation of foreign trade and exchange when it introduced, in March 1946, the so-called "50 per cent system" which permitted exporters to retain or sell one-half of their hard currency earnings, on condition that it was utilized within a short period for the purchase of licensed imports.2/ This legislation resulted in the coexistence of the official exchange rate at which one-half of the foreign exchange proceeds were ceded to the Exchange Control Office (Italcambi), and the far higher free rates prevailing in the market for the other half.

The original objective of this arrangement was to provide an incentive for exports without an open depreciation which would have had unfavorable psychological consequences and would also have put more lire into the hands of the then still numerous Allied troops in Italy. Its principal merit proved to be the flexibility it afforded at a time when both internal Italian and world prices were subject to wide fluctuations. The main defects of the 50 per cent system were the following:

1) Since it applied only to hard currency proceeds of exports, there occurred a diversion of Italian exports from countries with which Italy had payments and clearing agreements. Italy, therefore, became indebted toward several European countries with resulting gold and dollar transfers. At the same time, the stimulus given to exports to hard currency areas which included the sterling area, resulted in the accumulation of substantial amounts of unutilizeable sterling.

2) The portion of foreign exchange proceeds ceded to Italcambi being retained for essential government imports, foreign exchange needed for commercial imports had to be bought at the high free market rate while foreign exchange obtained by exports yielded only the average between the free and the official rate. This disparity resulted in discrimination against those producers who rely on the export of finished products manufactured from imported raw materials (as against those who export, e.g., domestic fruits and vegetables).

3) Specific disadvantages of the system have been (a) the impossibility of declaring a par value for the lira to the Fund and the resulting inability to use the normal procedure for drawing on the resources of the

---

1/ For steps in the same direction, see for Germany, this Review, August 26, 1947; for France, this Review, September 23, 1947; for Greece, infra.
2/ See this Review, March 11, 1947.

Fund; (b) the assessment of U.S. customs duties on the basis of the official rate with the result that imports from Italy had to pay several times as much in duties as they would have paid had the actual export rate (i.e., the average between official and free rate) been the official rate.

Successive Modifications of the System

Most of the modifications which the 50 per cent system has undergone since its inception may be explained in terms of successive attempts to correct its various defects while maintaining the principle of flexibility. During the first year the system was extended to cover freight earnings, remittances, and tourist expenditures. However, since dollars quoted in the neighborhood of the legal free rate were available—either in the form of notes or through compensation deals--in the black market, it still proved unattractive for tourists and senders of remittances to buy lire at the average between the official and the free rates.

To eliminate the discrimination against exports to payments agreements countries, the exchange rate applying to several of these countries--Belgium, Poland, U.S.-U.K. zones of Germany--was based, in the course of 1947, on their official rates to the dollar with the lira-dollar rate recomputed every month at the average between the official rate and the average free rate of the preceding month. This average also applied after January 1947 to U.S. government expenditures in Italy.

To compensate for the previously noted discrimination against exporters having considerable foreign exchange expenditures, exporters of wool and cotton products as well as shipping companies received preferential quotas of foreign exchange far in excess of 50 per cent. This change, introduced in August 1947, was inspired by the increasing foreign competition encountered by Italian textile producers. It resulted, however, in a bewildering variety of rates and in considerable pressures brought by other categories of exporters to obtain similar advantages.

New System Introduced

The unhappy experience with this phase, and the continued failure of Italcambi to capture foreign exchange income from tourist trade and remittances were among the main motives for the adoption, on November 28, of a new system which constitutes an interesting innovation in the field of foreign exchange regulation.

Earlier, on August 2, 1947, the differential between the official and the free rate had been narrowed by raising the official buying rate for the dollar from 225 to 350 lire. Now, it was decided to eliminate this differential almost entirely by having Italcambi acquire the 50 per cent due to it at the average free rate of the previous month. It might have been possible to go one step further and have a single, fluctuating rate, the daily free rate determining at the same time Italcambi's daily official buying rate, but the relative narrowness of the market and the desirability of having a foreseeable and moderately stable rate for payments agreements purposes induced the Italian exchange authorities to choose as the official rate the average free rate of the previous month.

The average of the free rate for November having been 603, this is the official buying rate for December. Supposing that the free rate in December remains in the neighborhood of the November level, the new exchange rate represents a rise in the average rate at which exporters sell dollars from $\frac{350 + 603}{2} = 476.5$ to 603, i.e., a devaluation of the lira by 21 per cent. This devaluation is not an incidental result of the new arrangement but was consciously aimed at since a considerable appreciation of the lira in the free market since May had endangered the capacity of Italian exporters to compete in world markets.1/ This appreciation, from around 900 lire in May to below 600, had taken place in both the free and the black market as a result of increasing confidence in the new de Gasperi Government and its Budget Minister Einaudi and the latter's credit restriction policy which forced considerable dishoarding of accumulated foreign exchange funds. A steeper rise of the lira, particularly in the black market, probably was avoided by Foreign Minister Merzagora's liberal authorization of franco valuta imports, i.e., imports of certain commodities financed by funds held abroad.2/ Many illegally held dollars that would otherwise have been thrown on the black market were thus repatriated in the form of commodity imports.

Aside from the additional devaluation, the main results of the new rate system are:

1) The elimination of the difference between buying and selling rates which discriminated against certain categories of exporters.

2) The elimination of all privileged positions of exporters with respect to the foreign exchange quota that has not to be ceded to Italcambi. Article 6 of the new decree specifically forbids Italcambi to let any acquirer of foreign exchange retain more than 50 per cent of his earnings. Actually, with the differential between free and official rates practically eliminated, the pressure for the granting of preferential quotas is bound to subside.

3) The official rate, i.e., the average free rate of the previous month, is applied uniformly to all payments agreements so that in this field, too, discrimination has come to an end.

4) Until now, the dollar note traded in the black market was at a slight discount with respect to the legal free market rates, a situation probably traceable to the fact that a dollar acquired in the black market cannot be utilized for imports as advantageously and conveniently as a dollar held in the private 50 per cent accounts. Because of this kind of connection between the free and the black market rates, these two rates may be expected to move at approximately the same levels--at least in the absence of large-scale flights and backflows of capital. The new rate system should, therefore, be able to achieve one of its avowed aims, i.e., bring foreign exchange receipts from tourist trade, remittances, and private foreign investments into legal channels.

5) Italy will still be ineligible to use the normal procedure for drawing on the resources of the Fund.

1/ In addition, Italian imports into the U.S. will now be valued by the customs at the new official rate rather than at the previous official rate the application of which resulted in a high incidence of customs duties (cf. above p. 7).

2/ Cf. this Review, May 6, 1947.

Some Problems of the New System

Can the Lira Appreciate under the System? The operation of the new system is not yet entirely clear in several respects. The decree specifies that the limits within which the official rate may fluctuate are 350 and 650 lire to the dollar.1/ However, the official buying rate of the dollar can fall from one month to the next only if Italcambi refuses to acquire more than the portion of foreign exchange due to it at the official rate whenever the free rate drops below the official rate. In this case, of course, it would be tempting for Italcambi to buy up some foreign exchange in the free market at rates more favorable than the official buying rate. That it is the intention of the Italian authorities to leave room for a future appreciation of the lira may be deduced from Article 5 of the decree. This Article stipulates that exporters who do not utilize their free foreign exchange earnings within the prescribed time limit (two months) must sell it to Italcambi at the official rate minus 20 per cent rather than, as heretofore, at the full official rate. This means that an exporter cannot escape selling his free exchange at a rate lower than the official buying rate, by simply letting the period expire during which he is supposed to utilize his free portion.2/

The Dollar-Pound Cross-Rate. At the moment of the Anglo-Italian Financial Agreement of April 1947, the Italian Government obliged itself to maintain the official dollar-pound cross-rate in Italian markets.3/ This proved an easy task during the short period of sterling convertibility which was one of the main subject matters of the Financial Agreement. When sterling convertibility was suspended, the Italian Government considered itself free from any obligation concerning the cross-rate and the pound sterling went back to its heavy (20-25 per cent) discount with respect to the dollar in the Italian stock exchanges. Now the official buying rates being nothing but average free rates will embody this discount. The power of the exchange authorities to manipulate the market through import licenses (see below) may prove embarrassing to the Italian Government in this connection. However, the case of the pound sterling may serve precisely to illustrate the limitations of this power. Since Italy has already substantial sterling holdings which it is eager to utilize, only license requests for quite unessential imports are presumably turned down. In other words, the exchange control authorities have but little room left for influencing the demand for sterling.

"Free" Rate Vs. "Equilibrium" Rate

A more fundamental question is that of the actual significance of the "free" rate as a measure of the "equilibrium" rate at which final stabilization presumably is to take place. This so-called free rate is actually far from being free in the traditional sense since the demand schedule for foreign exchange is subject to manipulation by the Government which can

---

1/ The official rate is actually computed by counting all free market quotations above 650 or below 350 as 650 and 350, respectively (Article 2).

2/ The first information on the development of the free rate under the new system actually shows the free rate at a discount with respect to the official rate (see Table).

3/ Cf. this Review, May 20, 1947.

Lira-Dollar Rates
December 1945 - December 1947
(lire per one dollar, monthly averages)

	Official Rate (1)	Free Export Rate a/ (2)	Average Rate (1) + (2) / 2	Black Market Rate b/
December 1945	100	--	--	385
1946				
January	225	--	--	382
February	225	--	--	350
March	225	--	--	304
April	225	--	--	281
May	225	364	295	333
June	225	377	301	366
July	225	478	352	401
August	225	505	365	483
September	225	596	411	530
October	225	600	413	523
November	225	568	397	611
December	225	568	397	683
1947				
January	225	528	377	607
February	225	532	379	590
March	225	605	415	644
April	225	693	459	722
May	225	906	566	801
June	225	835	530	737
July	225	777	501	672
August	350	733	542	635
September	350	668	509	664
October	350	619	485	647
November	350 c/	603	477	568
December	603	567 d/	585	578 d/

a/ Rate at which exporters sell one-half of their foreign exchange earnings, the other half being ceded at the official rate to Italcambi.
b/ Price of the one dollar bill in Rome.
c/ When the new system was announced on November 28 a provisional official rate of 589 lire based on free rate quotations of the preceeding 5 days was maintained until the total November average could be computed.
d/ Average of first four days of December.

Sources: Bank of Italy, Bulletin of Statistics; Lettera d'Affari, Florence; "Il Globo", Rome.

increase or reduce the number of bidders in the free foreign exchange market by varying the number of import licenses issued. Theoretically, it is, therefore, quite possible for the "free" rate and the "equilibrium" rate to move in opposite directions. Actually, however, the Exchange Control authorities are likely to dampen, rather than to reverse, the tendencies of the market. Suppose, for instance, that as a result of increased exports the supply of foreign exchange increases; in this case, some pressure on the dollar will presumably be allowed to manifest itself, but Italcambi is also likely to liberalize its license-issuing policy. Stable exchange equilibrium in the traditional sense is reached only when, at a given rate, no more licenses are applied for than the Exchange Control authorities can grant without causing pressure on the rate; i.e., when the need for exchange control itself disappears. This is certainly far from being the case in Italy.

In a press release dealing with the new Italian exchange rate system the International Monetary Fund expressed, as a matter of principle, its aversion toward fluctuating exchange rates, but noted that Italy's action brought the actual exchange rate nearer to its equilibrium level and did away with various discriminatory practices. While the Fund judiciously refrained from either blame or praise, Italy's attempt to feel its way toward a realistic exchange rate will be watched with keen interest by all countries with overvalued rates.

GREEK FOREIGN TRADE AND EXCHANGE POLICIES

J. Herbert Furth

Despite generous American help, the economic position of Greece has continued to deteriorate. During the first nine months of 1947, domestic prices rose by approximately 60 per cent, note circulation increased by 20 per cent and the already depleted gold and foreign exchange reserves dropped by 20 per cent. These changes further weakened confidence in the domestic currency. Although the level of production remained about unchanged, advances granted by the Bank of Greece to borrowers other than the Government rose by 50 per cent, and it is to be feared that a large part of these advances was used for purposes of speculation (especially the purchase of gold sovereigns) rather than of productive investment.

Many observers felt that an important reason for the unsatisfactory international economic situation was the discrepancy between official and actual exchange rates. Officially, the drachma was pegged to the dollar and the pound sterling at the rates of 5,000 and 20,000 drachmas, respectively. Unofficially, throughout the spring and summer of 1947, the dollar was traded at a rate of more than 8,000 drachmas. Moreover, the gold sovereign, which on the basis of the official U.S. gold price would be worth $8.24 or approximately 41,200 drachmas according to the official, and 66,000 drachmas according to the black market dollar rate, actually was traded officially by the Bank of Greece at around 124,000 drachmas, and privately at around 140,000 drachmas.

The premium of the gold sovereign over the dollar is a phenomenon to be observed all through the Near East, but it has been particularly noticeable in Greece ever since the war when both the Allies and the Germans shipped sovereigns to their Greek adherents. The sovereign is regarded generally as the ultimate standard of value and, therefore, the favorite object of hoarding: from banker to peasant, everybody tries to convert his savings into sovereigns, and so far all attempts at discouraging this wasteful habit have been in vain.

In view of the overvaluation of the drachma in terms of dollars, imported goods, especially if purchased for foreign exchange at the official rate, could be sold domestically at tremendous profits; and, even more important, exported domestic goods, especially if sold for foreign exchange at the official rate, brought substantially lower returns in terms of drachmas than if sold on the domestic market. Thus excessive imports were stimulated and exports discouraged. This situation, however, was not due entirely to the unrealistic level of the official exchange rates. The domestic price level, exceeded 250 times the prewar level, while the world market level in terms of drachmas, even at black market rates, was only about 120 times as high as prewar.

The excessive level of domestic prices in relation to the world market level has been attributed to the disorganized state of the Greek economy, and especially the high cost of domestic transportation and marketing. An additional explanation may be found in the almost complete separation of the markets for foreign currency and foreign commodities: the bulk of the dollar currency appearing on the black market stems from remittances sent from the United States to Greek private individuals and probably only a fraction of that currency finally reaches importers able to smuggle it out of the country again in payment for goods. The larger part probably remains within the country and is used as a secondary means of hoarding.

Establishment of Flexible Exchange Rates

In order to do away with the discrepancy between the official and the actual value of foreign exchange, the Bank of Greece, as of October 12, 1947, established de facto flexible rates for drachmas in terms of dollars and sterling. The Bank continues to buy and sell foreign exchange at the official rates, but issues to sellers of dollars and sterling so-called Foreign Exchange Certificates for an amount equal to that of the sale. Buyers of foreign exchange must tender the Bank Certificates for an amount equal to that of the purchase, in addition to the payment at the official rate and to the presentation of an import license or of other documents approving the transaction.

The Certificates are in bearer form and are valid for 120 days from the date of issue. They are traded on the Athens stock exchange. Foreign exchange transactions amounting to less than $100, or in the case of larger transactions, fractions of $100 can be handled in such a way that the seller of foreign exchange receives from, and the buyer of foreign exchange pays to, the Bank the equivalent of the market price for Certificates for the amount in question, in addition to the value at the official rate. The Bank may issue Certificates also for currencies other than dollars and sterling.

Imports of basic necessities may be exempted from the requirement of the tender of Certificates so that their cost to the buyer should remain unchanged. Trade on the basis of approved barter or clearing agreements also may be excepted from the certificate requirements.

The pr . of the Certificates was set i· ·ially at 3,000 drachmas per dollar and 5,000 drachmas per pound. This made the actual price of the dollar 8,000 drachmas and that of the pound sterling 25,000 drachmas, about corresponding to then current black market quotations. The cross-rate between dollars and sterling thus was lowered from about $4 to $3.125 per pound, depreciating sterling in terms of dollars by 22-1/2 per cent. Since the parity exchange rate for the Greek drachma has not yet been approved by the International Monetary Fund, the action does not seem to violate the rules of the Fund. It is hard to see, however, how this cross-rate can be maintained officially once the parity rate for the drachma is set.

Establishment of Foreign Trade Administration

At about the same time, the Greek Government prepared a bill, passed by Parliament on October 25, establishing a foreign trade administration and aimed at unifying the foreign trade and exchange policy. A Foreign Trade Board consisting of four members of the Cabinet, the Governor of the Bank of Greece, and an Executive Director of American nationality, will outline a comprehensive foreign trade program and issue rules for government imports and exports,1/ the negotiation of trade and payments agreements, the issue of import and export licenses, and the establishment of uniform price and trade statistics. The Executive Director, within the limits of these regulations, will supervise the government imports and exports, initiate and conclude trade and payments agreements, and issue import and export licenses. Foreign trade or exchange transactions in violation of the rules will be punished by imprisonment and heavy fines.

Increase in Customs Duties

On October 27, 1947, the value of the so-called metallic drachma, used in computing customs duties, was increased by 150 per cent and thus raised to 100 times prewar. This increase is slightly less than the rise in the international price level (in terms of drachmas) and only two-fifths of the rise in the domestic price level.

The move is considered a first step toward an adjustment of tax rates to the changes in the purchasing power of the drachma, and this adjustment in turn will be part of a proposed comprehensive reform of the public finance system, aimed at eliminating the chronic budget deficit.

Effects of the Measures

So far, the measures have not done much to eliminate the difference between official and black market rates. The price of the dollar certificates --which can be used only for the purchase of exchange for approved transactions--remained close to the initial level and was quoted at around 3,400 drachmas, but the black market rate of the dollar rose to 10,750 drachmas at the end of November. The spread between the official price (official exchange rate plus price of certificate) and the black-market quotation thus still amounts to about 2,350 drachmas per dollar, or about three-fourths of the

1/ In 1946, almost one-third of all non-relief imports were for account of the Government. If relief imports are included, the Government share exceeded two-thirds of the total.

pre-reform gap. The "free" market price of the gold sovereign, which had been relatively stable for several months, started to climb again and on Novmeber 29 was quoted at 189,500 drachmas. Prices in the Athens free market rose by about 16 per cent from the beginning of October to the end of November, reaching 306 times the prewar level.

No data are as yet available as to the effect of the measures upon foreign trade. Imports may be curtailed by the stricter controls, but the basic reason for the lag in exports still exists in view of the continuing discrepancy between domestic prices and prices in terms of drachmas on the international market. Moreover, the confidence of the Greek population in the future of the domestic economy, and therefore in the stability of its currency, has not been restored, and the hoarding of gold and commodities is not likely to be checked. As long as the future of Greece remains uncertain, all economic measures--including economic aid from the United States--will be able at best to prevent further decisive deterioration, but will not bring about genuine recovery.

THE RUSSIAN CURRENCY PURGE

Alexander Gerschenkron

The Soviet reform of money, prices, and distribution, together with the flight from the ruble that preceded it, have received considerable publicity in the daily press. No detailed restatement of the decree of December 14, 1947, is therefore attempted in the following comments.

Exchange of Currency

The exchange of notes in circulation for new notes at the ratio of ten to one, is doubtless the crucial aspect of the reform. Unfortunately, quantitative appraisals are very difficult as no data on note circulation have been published since 1937. Nevertheless, an estimate of the possible magnitudes involved may be attempted. Scrutiny of the budgetary accounts over the years 1941-1947 reveals annual gaps between total expenditures and the sum of the itemized revenues (including proceeds from domestic loans). These differences amount in the aggregate to some 500 billion rubles. Can this figure be taken as a measure of the increase in circulation? This may understate the actual development inasmuch as additional notes may have been issued by the Central Bank (Gosbank) as working capital credits for state enterprises; such credits are not channeled through the budget. On the other hand, some portion of the gap may have been financed by unrecorded revenues, while another portion may have been reflected in a growth of deposits rather than in currency inflation. Nevertheless, in default of other data, it might be assumed for the sake of illustration that these subtractions from or additions to the note issue balanced each other and that the increase in note circulation amounted to 500 billion rubles.1/ In 1937, notes in circulation

1/ The official statement speaks of the addition to the note circulation of ruble notes counterfeited by the Germans during the war. It would seem that such increases must have been so insignificant in relation to the total note circulation that they can be safely neglected here.

NOTE: The writer is indebted to Dr. Paul Baran of the Federal Reserve Bank of New York with whom he exchanged opinions on the subject of this article.

amounted to 11.2 billion rubles, having increased about fivefold between 1930 and 1937. Even if allowance is made for the effect of war preparations in 1938-1940, it is unlikely that the note circulation had reached the 50 billion mark by the outbreak of the war. On the basis of these uncertain estimates one might assume at least a tenfold increase in note circulation between 1941 and 1947.

The significance of a note circulation of 500 billion rubles in terms of other elements of the Russian financial structure may be shown as follows: in 1937, the note circulation equaled about 11 per cent of total budgetary expenditures of the same year; in 1947, the (estimated) note circulation of 500 billion rubles would amount to 134 per cent of total budgetary expenditures. In spite of this situation, prices of consumers' goods at the end of the war were only about 23 per cent higher than in 1940. The prices of rationed goods were increased last November by some 180-200 per cent which implies a total increase over the war period of about 220-250 per cent. True, prices in the commercial stores where commodities were sold without quantitative limitations were many times higher than prices of rationed goods, and so were the open-market prices at which surplus farm produce over and above deliveries to the Government was sold. There is reason to believe, however, that for the vast majority of the urban population both commercial stores and open markets played a very subsidiary role in the supply of consumers' goods. Thus, the general postwar picture in Russia was one of a moderate open inflation and, if the estimate of note circulation has any relation to reality, of an enormous repressed inflation.

Reduction of Deposits

The conversion of cash holdings does not formally discriminate against, or in favor of, any group of holders, and affects currency holdings of private individuals, state enterprises, cooperative enterprises, and collective farms alike. In the scaling down of bank deposits, however, the reform distinguishes between three groups of owners: (a) Bank deposits of private individuals are to be reduced in accordance with a scale which, after exempting the first 3,000 rubles, reduces the following 7,000 rubles by one-third, and any amount in excess of 10,000 rubles by one-half; (b) Deposits of cooperatives and collective farms (i.e., non-state enterprises according to Soviet legal concepts) are to be reduced by a flat 20 per cent; (c) All other deposits, including those of state enterprises, are not to be reduced at all.

The decision not to reduce deposits of state enterprises follows essentially from the decision to maintain the money income of wage earners. Their working capital, therefore, is diminished only to the extent to which they were keeping balances in currency, a practice which has been consistently discouraged by the Gosbank. The somewhat less favorable treatment of cooperatives and collective farms is presumably predicated (1) on the relatively high profits earned by the cooperatives since their revival in November 1946 and by the collective farms for several years past; and (2) on the slight role played by money wages on the collective farms.

An estimate of the size of the deposits of the two types of organizations just mentioned cannot be made. Deposits of private individuals consist of deposits in savings banks and in the Gosbank. The value of the former has been reported at 12 billion rubles at the end of 1946, and was expected to increase by the end of the current year to 13.5 billion rubles. The amount of individuals' deposits with the Gosbank is unknown, but is unlikely to be very large, inasmuch as the practice of such deposits originated rather late in the war. Both savings deposits and Gosbank deposits of private individuals cannot be but a small fraction of the total increase in the media of circulation.

Reduction of Government Indebtedness

The compulsory reduction of the government debt is an altogether unexpected feature of the reform. The reduction does not extend to the most recent 1947 loan. Furthermore, the relatively small 1938 loan (about 14 billion rubles) is given preferred treatment in comparison with the rest of the debt. The bulk of the government debt, however, including loans floated as early as the middle 'thirties and amounting to some 164 billion rubles, is to be cut by two-thirds of the face value. At the same time, a compulsory conversion fixes the rate of interest for the whole amount at 2 per cent. Since the average interest rate on the public debt was 4 per cent, with very little dispersion on the individual issues, the measure involves halving of the interest rate in addition to the elimination of two-thirds of the principal. Thus a 1,000 ruble bond of original face value will bear only 6.7 rubles interest a year instead of 40 rubles, a reduction by five-sixths. The resulting budgetary saving of some 5 billion rubles a year is very small in comparison to the size of the budget, but is likely to be sizeable in comparison to the note circulation left after the currency reform. In addition, there will be budgetary savings in amortization of the bonds. Last February, Zverev, the Minister of Finance, stated that attainment of budgetary surpluses was regarded by the Government as a central factor in anti-inflationary policies. The currency reform may indeed lend significance to the anti-inflationary policy of budgetary surpluses.

Abolition of Rationing and Reform of the Price System

The fact that currency reform has been delayed for almost three years after VE Day has enhanced the economic difficulties in Russia during the intervening years. That it has now occurred presumably means that the Government is now able to provide more consumers' goods than would have been available in 1945; accordingly, the danger that liquid funds will begin to reaccumulate on a large scale immediately after the reform is undoubtedly much smaller at the present time. The abolition of rationing is accompanied by the elimination of the dual commercial store - rationed good store price system. Single prices are established for each commodity in all government stores. There will still remain, as was true before the war, free open-market prices at which collective farmers may sell their surpluses. The level of those prices will depend on the degree to which the Government satisfies the consumers' needs through supplies in the government stores. As far as the price adjustments decreed in the latter are concerned, an appraisal is rather difficult. This much, however, is clear: the new price level will be very considerably below that formerly prevailing in the commercial stores. Thus prices of textiles and shoes are to be fixed at about one-third of the former prices in commercial stores. For prices of rationed goods, the situation is much less uniform. Prices of bread, cereals, and beer are to be reduced by 10-12 per cent. A number of prices (those for meat, fish, sugar, potatoes, vegetables, tobacco, and alcohol) are to remain unchanged. But the prices of milk, eggs, tea, and fruit are to be increased in comparison to the previous rationed prices, and so are prices of textiles and shoes.

Appraisal of the Reform

Effect on Incomes. The reform decree stipulates that money incomes of wage earners and collective farmers will remain unchanged. How will real incomes be affected? In the official statement of the Soviet Government and the Communist Party it is claimed that real incomes will be increased as the new prices are fixed below those previously charged at the commercial stores. There is no doubt that the real incomes of people who purchased a large part of their requirements at such stores will be favorable affected. If it is true, however, that only persons in high income brackets belonged to that category, and the average wage earner had only occasional recourse to the commercial stores while purchasing the bulk of his requirements at the rationed goods stores, then the latter is likely to see his real income diminished. The 10-12 per cent reduction in the price of bread is likely to be more than offset by the increases in the prices of clothing and shoes. The latter is particularly onerous at a time when consumers' inventories of these goods are still depleted.

The abolition of rationing and the restoration of consumers' choice doubtless entails some--partly intangible--gains to all consumers. On the other hand, it may be possible, in the short run, to make a distinction between the effect of the currency reform on real income and its effect on the standard of living; the likelihood is that the forced conversion of currency and savings deposits will reduce the average wage earner's ability to purchase durable consumers' goods out of savings. The presumption is that the establishment of the new price level favors only recipients of high incomes and places additional burdens on the receivers of average and low incomes.

The preceding considerations are based on the assumptions that the Government will be able to satisfy the demand which will be forthcoming at the new prices. It may, indeed, be expected that as a result of a rather plentiful harvest and the delayed abolition of rationing (which was generally expected at the time of the thirtieth anniversary of the October Revolution) bread will be plentiful throughout the remainder of the year. But it is a moot question to what extent consumers will find the stores supplied with other goods, particularly with industrial consumers' goods.

The Incidence of the Monetary Reform. As suggested in the preceding section, a striking feature of the currency reform is its neglect for the interests of the low-income groups of the population. The flat diminution of all currency holdings by 90 per cent means that the 100 rubles worth of notes held by an unskilled laborer will be diminished in the same proportion as the 100,000 rubles of a highly paid artist, or a black market speculator, or a soldier who returned from the war and enriched himself by the sale of looted goods. Likewise, the margin of protected savings to be revalued at the rate of one to one is only 3,000 rubles, a sum which amounts to less than 40 per cent of the present average annual wage in Russia. No less important is the fact that the revaluation ratio for deposits ceases to be progressive after the first 10,000 rubles and becomes a flat 50 per cent ratio. Those who are accustomed to associate the idea of social justice with progressive taxation will find reason to criticize the Russian reform on these grounds.

The distribution of savings always has been very uneven in Russia. Thus, in 1938, 67 per cent of the depositors owned only 5 per cent of the total value of savings deposits. It is likely that the distribution both of savings deposits and of the much more important note hoards has become even more uneven as a result of the war. Furthermore, the probability, if not actual certainty, is that the vast majority of the note holdings were concentrated in rural rather than in urban areas. Through open and black markets the peasants doubtless were able during the war to syphon out of the urban population the bulk of the notes which accrued in the first instance to urban consumers. While it would be out of all proportion to compare the present reform to the collectivization policy at the beginning of the 'thirties, the anti-peasant angle of the measure is a very important aspect of the reform.1/ To what extent political opposition of the peasants to the reform may be able to express itself is a question that cannot be considered here.

Currency - Government Debt - Savings. Neglecting certain exceptions mentioned earlier, the three types of assets were reduced by the reform in the following proportions:

currency	10 : 1
government debt	3 : 1
savings	2 : 1

That notes in circulation were treated more severely than the other two assets is presumably to be explained (1) by their quantitative importance in the aggregate, and (2) by the theory that speculators and profiteers have preferred this form of liquid assets. It might be noted in passing, however, that in a country with undeveloped banking habits, mattresses take the place of bank accounts for many who have no reason to conceal the origin of their funds.

The preferred position of savings as against government debt is perhaps more difficult to understand. Some explanations for the difference in treatment of government bonds as against deposits may be suggested: (1) government debt is quantitatively much more important than deposits; (2) the government may feel that it will be easier to apply pressure in order to

---

1/ According to a list of new prices published in Moscow on December 15, prices of industrial goods in rural areas are to be in general about 10 per cent higher than city prices for the same commodities. While a portion of the differential must be attributed to the cost of carriage, it is possible that some additional discrimination against the peasants is involved.

obtain subscriptions to government bonds than to induce people to carry their money to the savings institutions; and (3) reduction in the government debt has important long-run effects.

Concluding Remarks. It would be difficult to gainsay the rationality of the reform from the point of view of the economic policies of the Soviet Government. Any planning must be greatly jeopardized by the existence of huge hoards of liquid funds. In the crisis of October-November 1946, the Russian Government was given clear warning by the industrial workers that maintenance of the efficiency of labor depended on an increased supply of consumers' goods, including semi-durable goods. The industrial production program would be gravely affected if the increased output of consumers' goods were channeled to hoarders of cash rather than to the producers of goods. In the absence of currency reform additional severe controls would have been necessary to prevent that outcome. It has been repeatedly said that elimination of pent-up inflation does not *per se* create goods. This, of course, is true with the qualification that reduction of the peasants' cash balances may increase their readiness to market products in excess of those delivered to the Government. However, failure to get rid of surplus funds is very likely both to impede distribution and to hamper and restrict production.

It is, therefore, not the Russian reform in itself that invites strictures. Nor need criticism necessarily be directed against the magnitude and severity of the operation. But exception can be taken to the ruthless method of cutting with the same ax the savings of the poor and the profits of the rich. The Russian reform is in effect an imposition of a capital levy distributed with very imperfect regard to the income and wealth of the individuals taxed.

One final remark may be in order. There is every reason to assume that the currency reform will provide a considerable alleviation of the monetary situation. For some time, the inflationary pressures may disappear. It is, however, quite unlikely that they will remain in abeyance for long. In a full employment economy in which the ratio between investment and consumption is so greatly distorted in favor of the former, permanent inflationary pressures are virtually inevitable. The necessity for maintaining labor incentives is an effective barrier to anti-inflationary policy even for an omnipotent government in a thoroughly planned economy. Moreover, the very harshness of the reform may tend to reduce the propensity to save. However effective the present blow against pent-up inflation, the reappearance of current inflation in Russia is likely to be only a question of time.

CANADA ATTACKS ITS DOLLAR PROBLEM

Charles R. Harley

On November 17 the Canadian Finance Minister, Mr. Douglas Abbott, announced a series of measures designed to restrict the drain on Canada's resources of gold and United States dollars, and to supplement these resources by borrowing in the United States and by increasing Canadian gold production. The major elements of the program may be summarized as follows:

(1) Import prohibitions have been imposed on a long list of semi-luxury or non-essential goods such as certain food products, jewelry, radios, refrigerators, washing machines, and furniture. Automobiles were temporarily placed on the list of prohibited imports, but will be shifted to the "quota" list when detailed regulations have been worked out.

(2) Import quotas have been established for a wide range of (a) foodstuffs (fresh and canned), (b) finished textiles, (c) leather and leather products, and (d) miscellaneous goods including clocks and watches, sporting equipment, games and toys, and cutlery.

(3) Authority has been given to the Minister of Finance, acting on the advice of the Minister of Reconstruction and Supply, to introduce restrictions on the importation of "any metals or manufactures thereof" not included in either of the schedules referred to above (with the exception of machinery and equipment for use in agricultural or fishing industries). Imports of moving picture films may also be restricted under this authority.

(4) An annual ration of $150 per person has been set for funds for pleasure travel in a United States dollar area.

(5) The Export-Import Bank has authorized extension of a $300 million credit to Canada. In this connection, Mr. Abbott stated that Canada would investigate the possibility of borrowing from private investors in the United States and implied that funds so raised would be used to replace rather than to supplement the Export-Import Bank commitment.

(6) A program for stimulating Canadian gold production through subsidies has been proposed by the Government for Parliamentary action.

No estimate of the net savings to be expected as the result of restrictions (1) through (4) has been released by the Canadian authorities. On the basis of current Canadian trade with this country it appears that imports from the U.S. in 1947 may be reduced by $250-300 million, assuming that no significant restrictions are introduced under item (3). If tourist expenditures in the United States are reduced by 25 per cent an estimated additional saving of around $40 million might be expected. No estimate of the additional gold production which may result from the proposed subsidy program can be attempted at this time.

Before these measures are discussed further, it may be appropriate to review recent trends in the Canadian balance of international payments which explain why it has become necessary for Canada to apply severe restrictions on United States dollar expenditures at a time when Canadian exports are at record levels. The answer is to be found primarily in the fact that a large proportion of Canadian exports are being financed by loans and grants to foreign countries and thus are not giving rise to hard currency receipts which Canada might apply against its growing adverse balance with the United States. A rough comparison of Canada's balance of payments position in 1946 with the estimated position in 1947 is shown in the following data:

	1946	1947
	(millions of Canadian dollars)	
Export balance in current international account (including sales of non-monetary gold)	458	-0-
Less contributions to UNRRA and credits to foreign countries	969	610
"Cash balance" on current account	-511	-610

The "cash balance" deficit in 1946 was offset to the extent of $250 million by an inflow of capital and by postwar settlements so that Canadian reserves of gold and United States dollars declined by only $263 million. In 1947, however, a net outflow of capital has occurred with the result that official Canadian reserves of gold and United States dollars declined by nearly $750 million in the first 10 1/2 months of the year to a level of approximately $500 million on November 13.

Disappearance of the $450 million favorable balance on current account between 1946 and 1947 is attributable to a substantial increase in Canada's deficit vis-a-vis the United States. During the first eight months of the current year Canadian net imports of merchandise from the United States were running at an annual rate of $900 million, as compared with $430 million during calendar 1946. Rising prices of United States products and the increased availability of goods for export from this country, together with a high level of production and incomes in Canada contributed to a sharp rise in Canadian imports.

In order to apply the import restrictions without delay the Canadian Government, by Order in Council of the Governor General, amended the Foreign Exchange Control Act to provide that no currency shall be designated as payable for the commodities subject to the new restrictions unless specific exchange control licenses have been secured.1/ The Canadian Parliament doubtless will be asked to pass new legislation under which the import controls may be operated since the Foreign Exchange Control Act (passed only a little more than a year ago) contained language which the layman would interpret as prohibiting use of the Act for direct trade controls of the type now adopted. The candor of Mr. Abbott's remark may be appreciated: "At the time this Act was passed the Government did not believe that such power was contained in the Act but we are now advised by the law officers of the Crown that it provides the legal basis for such restrictions as are proposed."

The Canadian import restrictions are non-discriminatory in form. That they are in fact discriminatory against the United States is freely admitted; no other type of import restriction would appear reasonable in view of the character of the current Canadian trade difficulties. The products placed on the prohibited list are in general those of which the United States is the primary foreign supplier. The import quota system provides that the countries of the world shall be divided into two groups and that quota imports from each group separately may be admitted up to the value of 200 per cent of the 1937-39 value from that group. (The quota for textiles is 400 per cent of the 1937-39 value). Since imports from the small group of which the United States is the major member have recently been greater than the quota limit while imports from the other group have been substantially below that limit, quota restrictions will be effective only against the United States and a few additional countries.2/ Within Canada, licenses for quota imports will be distributed among importers on the basis of their share of the trade in the particular product during the year ending June 30, 1947.

Before instituting direct trade controls the Canadian Government had presumably informed the United States Government of the general nature of the proposed restrictions. On November 17, the U. S. Department of State released an exchange of notes which reveal full recognition of the increasingly precarious balance of payments position of Canada. The United States note indicates that this Government will not invoke certain articles of the 1938 trade agreement with Canada which prohibit discrimination against imports from the United States.

Canadian plans for subsidizing gold production, however, were apparently not discussed in advance with United States authorities or with officials of the International Monetary Fund. The original proposal, involving bonus payments of $7 per ounce of gold output in excess of production during the twelve months ending June 30, 1947, was looked upon with disfavor by the Fund. On December 11 Mr. Abbott proposed a new and more involved subsidy formula which the International Monetary Fund has

---

1/ The control became effective on November 18 and only goods actually in transit on that date were automatically exempt.

2/ Listed with the U.S. as "scheduled countries" are: Cuba, Dominican Republic, Guatamala, Haiti, Panama, El Salvador, Venezuela, Switzerland, and U.S.S.R.

found acceptable.1/ Through the National Advisory Council, the U.S. Government has expressed strong disapproval of any tendency for foreign countries to rely upon subsidized production of gold as a means of maintaining balance of payments equilibrium.

In general, however, it appears that the U.S. Government is in sympathy with Canada's efforts to lessen its balance of payments deficit with the United States. Quite aside from the obvious fact that some defensive measures had become necessary to curtail the rapid drain on Canadian gold and U.S. dollar reserves, the United States is interested in the ability of Canada to continue to finance a substantial portion of its export surplus with European countries. Unless the Dominion can restore a surplus in its over-all current accounts, Canadian loans or grants to Europe would result in further declines in gold and U.S. dollar reserves. These declines could only be offset by further borrowing from the United States, a prospect which does not appeal to the Canadian authorities.

1/ A more detailed review of the Canadian subsidy proposals and of the Fund's reaction thereto is contained in the article in this Review, entitled: "Canadian Gold Production Subsidy".

CANADIAN GOLD PRODUCTION SUBSIDY

Mary Maroney

When the Canadian Government announced import restrictions and other features of its dollar saving program on November 17, there was also announced a proposed three year arrangement to stimulate gold production by paying $42 an ounce, instead of the standard price of $35, on that part of each mine's yearly gold production over and above the amount produced in the fiscal year ended June 30, 1947. This plan, however, apparently had not been discussed in advance with United States authorities or with officials of the International Monetary Fund, and the Fund found the plan objectionable as involving the payment of a premium price for gold in violation of the Fund agreement. The Canadian mining industry, which had been protesting its inability to make ends meet because of the rising level of production costs, also objected to the plan as not sufficient for its needs.

On December 11, the Canadian Government made a revised offer, involving a more complicated and not so direct subsidy for increased production. Under this plan, the Government proposes to pay half the production cost above $18 per fine ounce for all gold output in excess of two-thirds of the amount produced in the fiscal year ended June 30, 1947. The International Monetary Fund stated that this plan was "not inconsistent with" Fund policy. In Washington, however, the National Advisory Council issued a warning that: "The United States would view with disfavor any tendency for countries to become dependent on subsidized gold production as a solution to the problem of arriving at and maintaining equilibrium in their balances of international payments".

The $18 figure announced as the base of the new subsidy is about the average cost of production of mines in the auriferous quartz industry in 1941, the year of peak output before war controls shut off supplies and manpower, and gold recovery began to fall. By 1945, production had fallen to 2,697,000 ounces, and average production cost had risen to $26.10 an ounce. In the year ended June 30, 1947, production totaled 2,914,000 fine ounces, or 55 per cent of 1941. Production costs probably had risen another 15 per cent - i.e., to around $30 an ounce.

No indication of the possible results of the new offer is reported as having been given officially. There are many high cost mines, as well as a considerable number of those in the low cost group which could extend production into higher cost ore.

There is no basis for making any reliable estimate of how much a subsidy might increase gold production. If we were to assume, however, for purposes of comparing the subsidy plans, a 25 per cent increase in production under both the original and revised proposals, the cost of the subsidy would work out about as indicated below.

Plan of November 17

	Amount (Thousand ounces)	Value (Million Can.$)
1. Assumed production, year ending June 30, 1948	3,643	127.5
2. Actual production, year ending June 30, 1947	2,914	102.0
3. Amount on which subsidy paid	729	
4. Value of subsidy paid ($7 an oz.)		5.1

Plan of December 11

	Amount (Thousand ounces)	Value (Million Can.$)
1. Assumed production year ending June 30, 1948	3,643	127.5
2. Actual production, year ending June 30, 1947	2,914	102.0
3. Subsidy base (2/3 of 2)	1,943	
4. Amount on which subsidy will be paid (1 - 3)	1,700	
5. Value of subsidy ($6 an oz.: i.e., 1/2 excess of 30 over $18)		10.2

The general position of the Monetary Fund was spelled out in a statement which asserted responsibility for examining the gold policies of member countries and authority to determine case by case whether subsidy programs proposed by member states were acceptable or not. The statement suggests that the Fund cannot, in general, prohibit domestic gold subsidy programs unless they "undermine or threaten to undermine exchange stability", or unless they take the form of "a uniform payment per ounce for all or part of the gold produced" which might be interpreted as establishment of a buying price for gold above the country's agreed parity valuation. The differences between the original and revised Canadian proposals will be that: (1) payments under the latter will be to the mines rather than for the gold; and (2) payments will presumably vary from mine to mine depending upon the levels of production costs. The practical difference between one form of subsidy and another may be negligible. Where the Fund's authority to prevent domestic gold subsidies appears limited, the United States, as the principal buyer of the world's gold production, could doubtless devise effective measures for nullifying the usefulness of such devices if this should become necessary.