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RFD.108

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

REVIEW OF FOREIGN DEVELOPMENTS

March 8, 1949

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DOMESTIC EFFECTS OF CURRENCY REFORM IN WESTERN GERMANY

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The Western German currency reform of June 1948 1/ clearly shows the economic and social effects of a "modern" currency conversion, intended to end a period of repressed inflation 2/. Originally, holders of money and monetary claims were to receive 10 new German marks for 100 old reichsmarks, with a minimum per-capita allocation of 60 marks for individuals and special provisions for holdings of business enterprises and public authorities; one-half of the new mark accounts of individuals and business enterprises, however, was "temporarily blocked". An amendment of October 1948 cancelled 70 per cent of these blocked accounts, released unconditionally 20 per cent, and promised release of the remaining 10 per cent for the purpose of medium or long-term investment. In this manner, the conversion factor for cash and bank deposits was changed from the original ratio of 10 : 100 to 6.5 : 100 or, if the amount available only for investment is disregarded, to 6 : 100. The conversion rate of 10 : 100 for monetary claims other than deposits was not affected by that change.

1/ See this Review, July 13, 1948.
2/ See this Review, February 22, 1949.

The amendment was immediately attacked by many and defended by few. The unconditional release of about 900 million additional marks increased the inflationary pressure which began to be felt at that time. The invalidation of the great bulk of the remaining accounts destroyed confidence in the promises of the occupying powers in general, and in the new currency in particular. Moreover, the amendment created without economic or social reasons a difference in the conversion factors for deposits and other claims: a businessman careful enough to cover all his debts by cash or deposits now found that his debts exceeded his liquid assets by more than one-half. It is true that debtors could apply to the courts for equitable reduction of their liabilities if the amendment created particular hardship; such a step, however, would be highly distasteful to a businessman eager to preserve his reputation for solvency.

The amendment represented a compromise between two schools of thought, one fearing an oversupply of money and therefore advocating a more stringent conversion factor, and the other fearing a deflationary scarcity of money and therefore advocating an additional cash release. Since it is virtually impossible during the first months following a "modern" currency conversion to foresee whether the effects will be inflationary or deflationary, the conflict between the two schools was not surprising; it would have been preferable, however, to adhere definitely to one of them instead of following an intermediate course which could not make sense under either assumption.

Taking into consideration the amendment, the currency reform reduced the money supply in Western Germany (currency outside of banks and bank deposits excluding blocked and interbank accounts) from an estimated 135 billion reichsmarks to about 12 billion German marks; in the six months following the reform, the money supply increased again by about 4.7 billion marks. Actually, only a fraction of the contracted money supply had been placed at the immediate disposition of the holders; the rise in money available for expenditures therefore was even greater than is indicated by the figures. The composition and development of the money supply in the second half of 1948 is shown on the following page.

The following discussion considers the influence of the reform upon production, employment, prices, income distribution, savings and investment, and public finance. 1/

Production

The index of industrial production rose in spectacular fashion in the bizonal area from 51 per cent of 1936 in June to 79 per cent in December. Actually, the expansion of output probably was not quite as large as the official figures indicate: before currency conversion, a substantial part of total output went into the "black" or "gray" market and probably escaped official

1/ A separate paper will deal with the influence upon international economic relations.

Western German Money Supply, December 31, 1948

				Billions of German marks
Composition:	Bank notes a/			6.0
	Central bank deposits b/:	public	1.35	
		private	0.2	1.55
	Other bank deposits b/ c/:	public	2.1	
		private demand	5.6	
		savings	1.4	9.1
	Total			16.65
Origin:	Currency reform:	individual	2.8	
		business	0.5	
		German auth.	2.5	
		occupation auth.	0.75	
		deposits (6%)	5.4	11.95
	Credit expansion since currency reform c/			4.7
	Total			16.65

Notes:

a/ excluding currency issued for the Western sectors of Berlin (0.4 billion) and currency held by banks (0.3 billion)

b/ excluding interbank deposits

c/ estimated on basis of 112 institutions statistics. The level of production in June 1948 may actually have been as high as 60 per cent of 1936, so that the increase in the second half of 1948 may have been 33 rather than 55 per cent of the June level. Such an increase would still be important enough: if production were to expand at a similar pace for another six months, it would approximate the 1936 level by the middle of 1949.

The rise in output cannot be attributed entirely to the currency reform as such. The end of repressed hyper-inflation, by whatever means it would have been accomplished, would in any case have stimulated economic activity by restoring financial incentives for labor and management and diverting manpower and resources from the black market into legitimate business channels. The removal of domestic economic controls, except for foodstuffs and some basic raw materials, and the increase in imports (due in part to ECA) also played a substantial role. However, the removal of controls would have been impossible without the weakening of inflationary pressure by the currency reform, and the development of foreign trade was partly the result of the reintroduction of a more or less effective rate of foreign exchange which in turn was connected with the currency reform. Thus, at least indirectly, the currency conversion was indeed an indispensible prerequisite of the revival of German production.

The figures relating to industrial production cannot be used without modification as a measure of national welfare. The population of Western Germany has increased by about one-sixth since 1936 so that per-capita industrial production is at present only about 67 per cent of 1936. Moreover, the production of many consumers' goods, especially leather goods, textiles, and clothing, is below the average.

Employment

At the time of the currency reform, unemployment was at a record low, standing in the bizonal area at 424,000 out of a labor force of 18 million. From the end of June to the beginning of September, unemployment almost doubled; it dropped somewhat until the end of November, and rose slightly in December to a year-end figure of 745,000. In the first six weeks of 1949, a further (partly seasonal) rise of about 275,000 was reported.

At the same time, however, employment in non-agricultural occupations increased. The number of wage and salary earners in non-agricultural enterprises rose from 10.8 million in June to 11.2 million in December. Unemployment and employment could both rise simultaneously because of the entry of a substantial number of people into the regular labor force. The addition to the labor force included students, housewives, and other persons who previously had not sought employment because of the lack of financial incentives; former black marketeers who were deprived of their livelihood; persons previously living on savings in money and monetary claims which had been reduced to 6 per cent of their former value; and city dwellers who had temporarily moved into the country in order to receive food and shelter from relatives or friends in return for some farm work.

To some extent, the rise in unemployment figures thus represented merely the unveiling of formerly "disguised" unemployment or the conversion of voluntary into involuntary idleness. In addition, however, the reestablishment of a system based upon money calculus inevitably led to readjustments in the labor force, and especially to the dismissal of inefficient workers, the contraction of less profitable lines of production, and the elimination of enterprises that could flourish only as long as the lack of supplies of essential products created markets for the most unessential goods and services. A certain amount of unemployment thus would have been the result of the end of repressed inflation in any case, regardless of the method by which that end would have been achieved. Even in the middle of February 1949, unemployment amounted to less than 6 per cent of the total labor force (including agricultural occupations and self-employed). The increase was disturbing, however, because of the memories of the early thirties when unemployment was instrumental in bringing the National Socialists into power, and the contrast with the situation under the National Socialist rule as well as under the Soviet rule in Eastern Germany, under both of which totalitarian planning had eliminated the unemployment problem, although at the expense of economic progress and individual freedom.

Prices

The official cost-of-living index in the bizonal area increased by only 7.5 per cent between June and December; but it has been admitted by official sources that the actual increase in prices was about 20 per cent since many price rises were not adequately reflected in the official figures and weights used in the index had become obsolete. Prices of rationed foods, which still are controlled and subsidized, were in December only about 150 per cent of prewar, but the prices of clothing and household goods had risen to about 230 per cent of prewar. Altogether, it may be assumed that the cost of living was actually in the neighborhood of 200 per cent as against the official figure of 144 per cent of 1938.

The increase since June 1948, however, is largely fictitious because the June figure took into account neither black market transactions nor the unavailability of many commodities at either legal or illegal prices. At the time of the currency reform, black market prices fell almost in proportion to the currency conversion factor. Since that period they have risen again, but probably somewhat less than legal prices. Moreover, many goods that used to be available only on the black market are now available through legal channels. Finally, even in commodities which still are traded in the black market, illegal transactions represent a much smaller fraction of total purchases than before the currency conversion.

Taking the developments in the black market into consideration, it seems unlikely that the average cost of living has increased at all. This average, however, is misleading in so far as various groups used to purchase very different fractions of their total needs in the black market, the proportion of black market purchases increasing with income. Low-income groups were therefore harder hit by the rise in legal prices, and benefited less from the drop in black market quotations, than high income groups.

The cost of living probably will further rise in spring when steps will be taken to eliminate the complicated subsidy system for foodstuffs (see below, page 9). It seems certain that such a further rise will be impossible without granting corresponding increases in wage rates, or substituting governmental cost-of-living allowances for commodity subsidies. At present, German food prices are only about half of the world market level. A substantial drop in world market prices will reduce the difficulty of the problem, but this drop hardly will reach dimensions sufficient to wipe out the difference between the German and the world market prices. The adjustment in food prices probably will be the most difficult change necessitated by the re-incorporation of Germany into the world economy.

The rise in prices had probably three main reasons: It was in part, like the increase in unemployment, the inevitable consequence of the adjustment of the economy to the reestablished mechanism of a market economy. It also was an after-effect of the stagnation of production under repressed inflation, which made the economy enter the post-inflation period with an appalling lack of commodities. Finally, it was the expression of an abnormally low propensity to save, which resulted in the continuation of inflationary tendencies even after the pressure created by repressed inflation was eliminated. 1/

Income Distribution

Gross national production in Western Germany has been estimated for 1948 at the equivalent of about $26 billion, or less than 75 per cent of the 1936 level at constant prices. On a per-capita basis this figure would be reduced to about 64 per cent. Wages stand, in terms of money, at about 140 per cent of 1936; in real terms (assuming an effective price level of 200 per cent of prewar) they are about 70 per cent of prewar or somewhat above the average per-capita proportion. In the six months following the currency reform, average hourly earnings have increased only about 10 per cent, or about one-half of the rise in legal prices. This lag, however, does not indicate a decline in effective purchasing power since the rise in legal prices has been offset by the decline in the level and volume of black market transactions (see above, pages 5 and 6). Moreover, employment and working hours have risen so as to increase total payrolls by about 20 per cent. This figure probably represents the actual size of the improvement in the real income of the working population.

1/ See this Review, February 22, 1949, and below, page 8.

It is true, however, that the purchasing power of wage earners has risen less rapidly than that of businessmen. Although no reliable statistics are available, the mere fact that prices rose faster than wage rates while production increased by leaps and bounds, leads to the conclusion that profits rose tremendously. It may be objected that this increase is somewhat illusory because pre-conversion black market transactions used to be more profitable than post-conversion legal transactions. Paradoxically, however, black market profits were probably distributed in a more "democratic" way than legal profits: small farmers, small shopkeepers, housewives, workers, and unemployed all had an opportunity to share in gains from black market transactions, while the bulk of legal profits accrues to more substantial property holders.

This redistribution of income probably accounts for the rising social tension. Under repressed inflation, with rationing and price controls rigidly enforced, the well-to-do had to share to a large extent in the privations to which the community was subjected. After repressed inflation had ended, the resulting adjustments favored property holders (except for holders of money and monetary claims) because the continuing scarcity of supplies in relation to pent-up demand made possible immediate windfall profits. The continuation of this trend for more than six months has further widened the gap between the economic position of wage earners and property holders. This is particularly dangerous because the severity of social tension seems to be more closely connected with the relative position of the low-income to the high-income groups than with the absolute level of welfare. Although there can be no doubt that low-income groups in Germany today are far better off than they were before the currency conversion, they seem to be more dissatisfied. The ranks of the dissatisfied have been swelled--exactly as after the First World War--by those who had invested a large part of their wealth in money and monetary claims. It is true that most of these people used to belong to the higher-income groups and that their losses therefore resulted in a more egalitarian distribution of income. By and large, however, social tension is created less by the behavior of the typical "rentier", who is an elderly person leading a quiet unostentatious life, than by the conspicuous display of wealth by the active businessman and his family. The change in income distribution within the upper-income groups from "rentiers" to businessmen therefore tends to increase rather than lessen social tension. These social consequences probably have withheld from both the occupation powers and the German authorities the popular praise for their work on behalf of the currency reform, to which they would be entitled on the basis of purely economic consideration.

Savings and Investment

The amendment voiding the greater part of the blocked accounts was another blow to the will to save, which was already sapped by the effects of inflation and the pent-up demand for goods. Up to the end of the year, savings deposits failed to increase except as the result of mere bookkeeping devices, i.e., the gradual transfer of cleared amounts from blocked to free accounts.

Probably the only significant savings were represented by those parts of business profits that were reinvested in the enterprises of their owners. It had been hoped that the "counterpart funds" accumulated through the mark payments of German importers for goods, the importation of which was financed by the U. S. Army authorities and by ECA, would supplement private savings. Actually, however, the bulk of these funds had to be used for current expenditures, partly for mark outlays connected with foreign trade transactions and partly for the mark costs of the airlift to Berlin.

In view of the insufficiency of savings, the bulk of all investments had to be financed through credit expansion; this development probably was the main reason for the continuation of upward pressure upon prices. In order to halt both the increase in money supply and the rise in prices, the authorities tried in October 1948 to prevent commercial banks from expanding credit. The Military Government asked the Bank of the German States to raise the discount rate. The Bank refused to do so because it did not want to increase the cost of necessary investments; however, it instructed commercial banks not to expand total credits beyond the level of October 31, 1948. This instruction--which in view of the peculiar structure of the Western German banking system could not be reinforced by effective sanctions--was widely disregarded: the commercial banks continued to expand credit almost at the pre-October rate although they may have been more careful in scrutinizing the economic consequences of credit grants. Fundamentally, however, this method could not have succeeded in any case because credit expansion was only a symptom of the high propensity to spend. As soon as certain investments were recognized as essential, inflationary consequences had to be suffered until either private savings increased or the Government managed to accumulate a corresponding budget surplus.

In the second half of 1948, however, the inflationary pressure was largely offset by the increase in available supplies, the rise in the current output of goods and services (estimated at 33 per cent) being almost as rapid as that in the supply of money (40 per cent). If the rise in production were to level off, the lack of savings would become more dangerous.

Within the next few months, a new method of computing the mark value of U. S. financed relief imports to be paid into the "counterpart funds" 1/ will increase the significance of these funds as a non-inflationary source of investment. If present plans for using part of the funds as a working capital of long-term credit institutions are realized, an organized long-term credit market may be reestablished in the near future. Moreover, in recent months confidence in the preservation of political and economic stability seems to have increased. If this trend expresses itself not merely in a fall in black market prices for commodities and foreign exchange, but also a reduced propensity to spend, the inflationary pressure may finally come to an end.

1/ After April 1, 1949, these payments are to represent the full dollar value, converted into marks at the rate of 30 cents per mark, rather than merely the subsidized German domestic price of the imported goods.

Public Finance

During the first month following the currency reform, the States of the Western zones of occupation experienced a budget deficit of 500 million marks. It was caused mainly by a sharp drop in tax receipts, which in turn was due primarily to the fact that farseeing taxpayers had, in the period immediately preceding the conversion, discharged as much of their tax liabilities as possible. Tax receipts soon returned to normal, however, and the danger of a chronic deficit has disappeared. Normally, the fiscal situation could be expected to improve very substantially in view of the expansion of business, and especially the replacement of untaxed black market by taxable legal transactions and revenues. With the return of a sound currency, however, tax evasion once more has started to rear its head: in the past, under repressed inflation, money could legally be used for few purposes except paying taxes and therefore the incentive for tax evasion was far smaller than in normal times. After currency reform, the high tax rates again became a real burden and the scarcity of ready cash added to the temptation to use funds for purposes other than tax payments.

In order to counteract the tendency toward tax evasion, a number of tax rates have been reduced substantially. Still the overgrown bureaucratic apparatus, the cost of occupation, and at present the expenditures for the airlift to Berlin probably will continue to keep tax rates high enough to make evasion profitable. As the same time, the decentralization of the German administration, deemed necessary for political reasons, probably increases the costs and decreases the efficiency of fiscal management. None of these evils, however, were caused or could be cured by the currency reform.

On the other hand, the currency reform may make it possible to eliminate one large item from Government expenditures, namely, the subsidies paid for most staple foodstuffs and many basic materials, especially coal. During the period of repressed inflation such payments were necessary in order to provide incentives to the producers. At the time of the currency reform, the abolition of all subsidies was deemed dangerous since it would have increased the pressures for wage adjustments. The continued existence of these subsidies, however, seems inconsistent with the general principle of a market economy, and leads to misdirected and inefficient use of labor and other resources.

The present fall in world market prices, coming at a time when domestic inflationary pressure also begins to subside, would seem to provide an opportune moment for taking a decisive step toward the abolition of subsidies. Such a move might make possible a further reduction in the most abnoxious taxes and a concentration upon those sources of revenue the collection of which is least harmful to economic progress and least resisted by the taxpayer.

Conclusions

There is no doubt that the currency reform, by putting an end to the lack of financial incentives caused by the process of repressed inflation, has brought a tremendous recovery in production and consumption. Prices showed a distinct tendency to rise, probably less because the cut in the stock of money may have been too small than because the propensity to spend current money income continued to be abnormally high. This propensity, by making impossible the accumulation of adequate savings, resulted in the need for substantial credit expansion in order to finance essential investments. The change in the psychological climate, however, which occurred for no apparent economic reason during the first months of 1949, may put an end to the danger of renewed inflation. The fiscal situation also seems to have been stabilized.

The social effects of the currency reform are somewhat doubtful. Actual purchasing power of the working population has increased substantially, but the purchasing power of businessmen has risen even more. This fact seems to have increased social tension despite the improvement in the economic position of low-income groups. A more equitable distribution of income between wages and profits may be necessary in order to preserve social peace. At the same time, such a redistribution must not hamper the rise in the propensity to save needed for financing investment plans without inflationary consequences. Well-balanced fiscal measures, supplemented by a wise use of the "counterpart funds" resulting from U. S. aid, will be necessary in order to attain both the social and economic aims of financial policy in Western Germany.

THE SOVIET CURRENCY CONVERSION

Gregory Grossman

The Soviet currency conversion of December 1947, although definitely in the "modern" category, 1/ had certain features, which distinguished it from similar measures carried out in other European countries.

As a result of the years of war and postwar reconstruction, and of the inflationary legacy of the prewar five-year plans, the Soviet economy found itself towards the end of 1947 with a large monetary overhang, despite the upward wage-price adjustment of the fall of 1946. A comprehensive complex and austere rationing system was in force. Yet, many consumers' items (including foodstuffs) could be bought ration-free in the so-called "commercial stores" at very much higher fixed prices; and in the legal "open market", primarily for farm produce, at similarly high prices, freely determined by demand and supply conditions. The system of "commercial stores" and multiple fixed prices was reintroduced during the war, considerably after rationing was reimposed, in order to strengthen incentives for additional money earnings and at the same time to sop up money in circulation. While the open market was not a new feature, prices in it rose steeply under the impact of swollen wartime money supply. The result was a familiar one by now: with little available for the peasants to buy, and with respect to what they could buy, the terms of trade being greatly in their favor, they naturally accumulated very large money hoards during that period.

In addition, there was an extensive network of "departments of workers' supply" at enterprises, with distribution norms frequently varying with the worker's output and between enterprises. Consequently, the particular enterprise at which the worker was employed was often more important as a determinant of real income than the size of his money wage.

The situation before the reform was thus not strictly speaking one of repressed inflation, as goods were legally available--at inflated prices--in the "commercial stores", in the open market, even after all rations had been exhausted by the consumer. However, the problem of labor incentive was apparently not much less acute than in the case of an ordinary repressed inflation, probably because prices in the "commercial stores" and in the open market were prohibitively high, so that the attractiveness of additional money earnings to be spent in those markets was limited, unless the consumer's most basic needs were still unsatisfied. The "departments of workers' supply", although under proper conditions beneficial from an incentive point of view, may have caused unnecessary labor turnover and diverted resources from the main lines of production of the enterprises. Thus, new measures to increase labor incentives were called for.

The problem of entrepreneurial incentives under a situation of repressed inflation was most likely less acute than in other economies, but it

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1/ See this Review, February 22, 1949.

no doubt existed in peculiarly Soviet form, such as the concentration on private plots rather than collective farm crops in agriculture, and the weakening of "ruble discipline" 1/ in non-agricultural enterprises. However, the narrow field of decision left to the Soviet manager, and the constant supervision by state and party organs prevented that situation from becoming dangerous.

The price inflation in the open market is claimed to have reached a peak in 1943, when the price level was allegedly some 13 times that of 1940. By 1945, however, it was stated to have declined to about 5 times the 1940 level. The likelihood of a runaway inflation in the open market, especially after the good crop of 1947, was remote at the time of the reform. Inflationary financing of the needs of enterprises was most probably on the decline by that time, and the now reduced "commercial store" prices provided a rough ceiling to price increases in the open market. Thus, with reference to the open market, the purpose of the measures to be taken was not to halt a runaway inflation, but further to reduce open market prices (or in any case, to establish a better balance between prices in the "free" and planned sectors of the economy).

Towards the end of 1947 the good crop of that year and the substantial conversion of light industry to consumers' goods production prepared the ground for the carrying out of a reform. Under the rigid system of Soviet planning an "orthodox" solution of large-scale "de-control" and allowing prices in the state and cooperative sectors to "seek their level" with reference to the existing money supply, was certainly not to have been expected. However, a number of alternative avenues were administratively feasible under the Soviet system, among which the following may be mentioned:

(a) Money supply could have been left substantially unaffected, prices kept at the lower (ration) level, while rationing (and "commercial stores") were abolished. Needless to say, this would have only worsened the situation, as shelves would have been rapidly bared of industrial consumers' goods, if not of foodstuffs, in the course of which earners of current incomes would have lost out against owners of cash hoards, with corresponding detrimental effects on labor incentives.

(b) Rationing (and "commercial stores") could have been abolished and prices and wages raised by decree, so as to reduce the purchasing power of the monetary overhang to a desired level. While this would have given decided advantage to currently earned incomes, it would not have affected the <u>relative</u> distribution of accumulated purchasing power between the different groups of the population;

1/ i.e., the management of liquid funds strictly according to the financial plan of the enterprise.

i.e., peasants and other cash holders would have remained at a relative advantage as against the industrial workers. It was probably largely for this reason that this alternative was not taken, although a desire not to "tamper" with factor costs and producers' goods prices may have also played a role.

(c) The price structure and the rationing system could have been kept virtually as before, but the money supply reduced through a currency conversion, as has been done, for instance, in Czechoslovakia or Belgium. "Commercial stores" could have also been kept. Although quite practical, this alternative was not followed probably because it was felt that only a complete abolition of rationing could strengthen monetary incentives to a desirable degree, and that it would have other beneficial psychological effects on the population.

The solution adopted combined complete abolition of rationing (and of the "commercial store" and the multiple price system associated with rationing), some adjustment of prices substantially around the old lower (ration) level, and a most drastic wiping out of most of the purchasing power in the hands of the population. Wage rates were not directly changed, and hence producers' goods prices and factor costs remained unaffected. Substantial tax revenue was lost to the state as a result of the abolition of the higher "commercial" prices. 1/ Open market prices soon declined sharply. In effect, the reform revived the situation which obtained between 1935 and the outbreak of the war, when there was no rationing despite a chronic shortage of consumers' goods, and distribution was controlled by manipulation of the turnover tax so as to adjust aggregate prices of consumers' goods to aggregate consumers' incomes.

We may now look at several of the distinctive features of the reform. First, the extremely drastic nature of the conversion. Cash holdings by individuals and enterprises (other than banks) were converted at a flat 10 to 1 ratio, with no minimum exemption or other provision for individual hardship cases. Savings deposits were converted on a sliding scale, with minimum exemptions sufficiently high (3000 rubles) so that the reduction in aggregate savings deposits may have been no more than 10 per cent. Government bonds were converted at 3 to 1, with some exceptions. Bank deposits of state enterprises were not affected; those of cooperative enterprises were reduced by 20 per cent.

1/ The reform has been described and analyzed at length in this Review, December 16, 1947, and in P. A. Baran: "Currency Reform in the USSR", Harvard Business Review, March 1948. Probably the most interesting discussion of the reform by a Soviet source is to be found in G. Kosiachenko: "Sovetskaya Denezhnaya Reforma" (Soviet monetary Reform), Planovoye Khozyaistvo, No. 1, 1948.

Because immediately prior to the reform cash hoards, owing to their size and greater liquidity, constituted by far the most significant part of the purchasing power in the hands of the population, we may momentarily concentrate our attention on their reduction. Unless their size before the reform has been greatly underestimated (no data on currency circulation has been published since 1937) their tenfold reduction was probably unnecessarily severe and inequitable. Yet, although overconversion under other conditions may cause an undesirable deflationary spiral, as was pointed out in the preceding issue of this Review, no such danger was to be expected under Soviet conditions, where consumer behavior has virtually no influence on the short run course of production, and where the producer is not at liberty to "wait out" the deflation. Besides, the banking system stands ready to supply all cash needs of enterprises so long as they conform with the economic plan. A shortage of means of payment in a Soviet-type economy is no problem as long as facilities for the printing and distribution of bank notes exist. (This is not to underrate the hardships which individuals may have sustained). Thus, while the high conversion ratio and lack of minimum exemption provisions may be attacked on grounds of equitable distribution of the burden, they are not open to attack from the point of view of the dynamics of the economy.

Secondly, it may be argued that such a drastic outright confiscation of individual savings will adversely affect the propensity to save in the future. Yet, under Soviet conditions this argument loses much of its force. Even under peacetime conditions, individual savings have been hitherto determined at least as much by the shortage of consumers' goods as by a desire to save. Custom and convenience have caused them to be hoarded as currency, rather than be turned over to the State for investment. Voluntary savings have provided a very small fraction of funds going into net investment, the bulk being financed by tax revenue and industrial profits. Nor are voluntary savings likely to become important in the near future as long as the standard of living remains low and investment requirements high. 1/ Furthermore, truly voluntary savings, i.e., other than those caused by a shortage of consumers' goods, presumably constitute such a small fraction of national income that even if they are adversely affected by the monetary reform, they are not likely to increase greatly the demand for consumers' goods or the incentive to earn money incomes. The significance of the monetary reform is to be sought not so much in its effects on the propensity to save, as in the effects it might have on the "hoarding preference" of individuals--the preference to hold currency in a sock, rather than to deposit it in savings banks or to purchase government bonds.

1/ The net increase in savings deposits and purchases of government bonds--the latter usually ten or more times larger than the former--may have financed in 1947 as much as one-third of net investment in the economy. However, a large part of the purchases of government bonds could not be called voluntary savings, as they are made under strong pressure, and are in effect quasi-taxation.

The selective conversion of the different kinds of money supply was apparently aimed at just this problem of "hoarding preference". The preferential treatment of savings deposits and bonds as against currency holdings has been already indicated. Since as much as 250 billion rubles in currency holdings may have been wiped out by the reform, while about 100 billion rubles in bonds and only about 1.5 - 2 billion rubles in savings deposits were cancelled, it may be questioned whether "hoarding preference" could not have been more advantageously attacked without much loss in the effectiveness of the reform, were bonds and savings deposits treated even more favorably. Certainly, little was gained by the reduction in savings deposits, and the repudiation of the bulk of government bonds must have been particularly shocking to the population in view of the high pressure with which the government always applied for their subscription. Had it been deemed important to reduce the purchasing power represented by the bonds, this could have been done just as effectively by a temporary suspension of redemption and repurchase provisions. 1/

As far as can be judged, the reform has been quite effective in achieving its primary objective--the raising of labor incentives. Yet, it is unlikely that under conditions prevailing in the Soviet economy undue expansion of money supply will be avoided indefinitely, and that symptoms of repressed inflation will not reappear, if they have not reappeared already. The intensity of the present drive for greater supply (and better quality) of consumers' goods may be indicative of the precarious balance between money incomes and the supply of consumers' goods in the Soviet economy.

1/ The standard Soviet justification of the conversion of bonds has been the argument that they were acquired when the ruble "did not have its full value". Yet, the Soviet Government has never paid a "bond bonus" at times when the value of the ruble was falling, as would have been consistent with that argument. Furthermore, most of the bonds were bought in years when wage rates were lower than at the time of the reform, and actually the issue of 1938, when wages and prices were lower than in 1947, was converted at 5 to 1, while the issue of 1947 was converted in full.