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STABILIZATION EFFORTS IN INDIA

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Harrison Parker

Financial developments in India have until recently been dominated by an inflationary situation which had its roots in wartime and postwar deficit financing. During 1948 inadequacy of transport and shortages of essential goods continued to create sellers' markets. Real per capita income had fallen, not only from the wartime high, but also from the prewar level. During the first three months of 1949, both wholesale prices and the cost of living have declined slightly. However, activity in the capital markets is still at a low level, and the recently passed 1949-50 budget has a large deficit. Though signs can be found that inflation is at last under control, many of the objectives of the anti-inflation program announced in October 1948 have yet to be achieved.

After a sharp advance of prices in 1946 and relative stability through most of 1947, inflationary pressures gathered new momentum in the last few months of 1947 and the first half of 1948. The economic dislocations and loss of confidence accompanying partition of India into two Dominions, continued deficits in Government finances, and the decontrol of prices and distribution of essential commodities during this period all contributed to another sharp rise in the price level. The wholesale price index rose by 30 per cent from November 1947 to July 1948, reaching a level of 390 as against 100 for the year ended August 1939. The total volume of money, however, rose by only 5 per cent from the end of 1946 to the end of 1948, when it reached 22.2 billion rupees (U.S. $6.7 billion), or about 530 per cent of the money supply in March 1939. The monetary overhang of relatively inactive cash holdings built up during the wartime inflation seems thus to have been reduced during 1947 and 1948. Nevertheless, the sharp contrast between the ratios of increase since prewar, of money on the one hand and of prices or incomes on the other, indicates that a condition of abnormal liquidity still exists.

An atmosphere of insecurity and instability, and of uncertainty as to the Government's policy of investment and nationalization, prevailed through 1946-48. There was a steady decline in activity in the capital markets and the Government's program of borrowing from the public was virtually a complete failure. There was very little new private investment, but the Government continued to incur large deficits for military, relief, and rehabilitation expenditures and for investment in public enterprises and development projects.

The Government of India was faced with a complex situation in the fall of 1948. Although the rise of wholesale prices had apparently come to an end and the cost of living was showing signs of levelling off, the Government was committed to a large program of expenditures, which, if maintained at the prevailing rate and without an increase in total national output, would result in budget deficits which would be difficult to finance in non-inflationary ways. The warning signs were the failure of the Government's borrowing program, the continued stagnation in private investment, the rapid use of foreign exchange reserves for consumption goods such as food imports, and the low rate of savings by the people. It was not easy, from the political point of view, for the Government to propose a cut in its investment and reform program. Public attention had been concentrated, not on the basic causes of inflation, but on the rise of prices. Moreover, a cut in the Government's program without complementary positive encouragement to private capital, both domestic and foreign, to invest in India would not bring a real improvement of the underlying situation.

Faced with this situation, the Government of India apparently decided to deal with both effect and cause at once in order to make the mixture politically palatable, and on October 4, 1948, issued an anti-inflation program, which can be divided into three categories: first, to reimpose price and distribution controls on essential commodities; second, to keep down Government expenditures and to mop up surplus purchasing power; third, to increase the volume of essential goods and services by providing new incentives for private investment.

Steps to be taken under the second category included the balancing, at reduced levels of expenditure, of all budgets -- both of the central and provincial governments. New development plans were to be cut or postponed; new sources of income were to be developed for the provinces. The provinces were warned that no aid from the central government could be expected at present for the financing of such schemes as the abolition of zamindari (feudal landlord holdings) and prohibition of liquor sales. The small savings campaign was to be intensified. The use of Treasur Deposit Receipts by banks was to be encouraged. Repayments of income tax deposits and refunds of Excess Profits Tax are to be postponed for three more years, and company dividends are to be limited, in an effort to reduce purchasing power.

The last category of measures, those to stimulate production, includes concessions to business and industry, including liberalization of the present rules regulating the allowances for depreciation on plant and machinery for income tax purposes, the temporary exemption of new industries from income tax, and the grant of relief from custom duties for imports of essential raw materials and capital goods. Another objective of the anti-inflation plan was the reduction of labor-management disputes.

It is still too early to judge the effect of this program on the inflationary situation. Many economists in India now feel that the reimposition of some of the price and distribution controls was too severe a step to take in the light of the improving price situation, and actually may have served to prevent a further downward readjustment, since the Government had to refill the pipelines for official distribution. Even though a cut in Government expenditures is indicated by the relatively small decline in Government of India cash balances in the last half of 1948, the large deficit budgeted for the 1949-50 fiscal year (April to March) shows that a complete equilibrium between revenues and expenditures is not regarded as attainable A significant increase in the rate of private investment has yet to appear, and Government spokesmen have been exerting great efforts to allay the fears and uncertainties of the investing community.

It is evident that India's stabilization effort has not yet achieved success, and that much depends on political and world economic trends. A solution of the Kashmir dispute is required before political tensions between India and Pakistan can be eased and various agreements reached which would facilitate the expansion of overland trade and build up supplies of exportable goods. Adequacy of food supplies is still dependent on imports, even if better crops should be obtained than in the last few years. While India's balance-of-payments difficulties persist, restrictive licensing of imports from overseas -- not only of relatively less essential consumer goods but also of many other commodities when purchased in dollar areas -- will continue to exert pressure against a decline in prices. Because locomotive renewals have fallen behind, railroad transportation continues to be a bottleneck for the whole economy. For many reasons, progress in expanding agricultural and industrial production will not be rapid.

Prices

Relative stability in the price level was maintained through 1947 until December. At the end of the year, however, two factors caused a sharp rise in prices. The first was the monetary expansion accompanying the heavy Government expenditures for relief, rehabilitation, and military operations in Kashmir and Hyderabad which resulted from partition. More important for the price index, however, was the relaxation of national controls on prices and distribution of essential food and cloth which had been instituted during the war. Government purchases and distribution of domestically produced commodities were progressively terminated. This process of decontrol started in November and continued into 1948. As a result of these factors, the wholesale price index rose about 30 per cent from 302 in November 1947 to a peak of 390 in July 1948, thereafter levelling off at an average of about 383 for the rest of the year. During the latter half of 1948 price and distribution controls were reinstituted. In the first quarter of 1949, the overall wholesale price index fell to 370.

TABLE I

All-India Index Numbers of Wholesale Prices
Base: Year ended August 1939 = 100

Year	Food Articles	Industrial Raw Materials	Semi-Manufactured Articles	Manufactured Articles	Misc.	All Commodities
1947						
Jan	291	343	241	272	492	291
Jun	287	362	251	274	474	294
Nov	295	378	253	283	461	302
Dec	321	395	260	284	454	314
1948						
Jul	391	450	338	370	538	390
Aug	398	438	331	353	533	383
Dec	398	457	329	348	536	384
1949						
Mar	377	463	323	330	515	370

Source: Office of the Economic Adviser to the Government of India.

Part of the rise of this index after decontrol was fictitious, since only the official prices of controlled goods had been used in compiling the index while controls were still in effect. Black market prices had been much higher, and the average of prices actually in effect -- legal and illegal -- had certainly been somewhat higher, though there is no way of estimating just how seriously the index had understated the true average level of prices.

In comparing the structure of postwar prices with that prevailing in 1939, one finds that food prices are up more than those of manufactured goods. This is characteristic of the postwar situation in most countries. The indexes for both food products and manufactured commodities rose sharply after decontrol.

Prices of raw materials, chiefly agricultural products, had risen a good deal higher than food prices earlier in the postwar period. Most of India's exports fall in this category. During 1947 this part of the wholesale price index rose about 15 per cent, paralleling the rise in U.S. farm product prices. In 1948, although Indian raw material prices showed month-to-month variations which bore some similarity to the changes in U.S. farm product prices, the index rose 15 per cent during the course of the year while U.S. farm product prices declined about 10 per cent during 1948. (See Table I.) During the first quarter of 1949 prices of Indian raw materials, as a group, failed to decline as other Indian prices did.

The behavior of the prices of cotton, jute, and oilseeds, which make up 80 per cent of the raw materials index, is chiefly responsible for the movement of this index in the past year and a half. Cotton and jute crops in India and Pakistan have been smaller than prewar because of diversion of land to food production, and the crops now coming to market are unusually small because of unfavorable growing conditions last year. The partition of India has accentuated the shortages of cotton and jute in the Dominion of India: export controls of the Government of Pakistan and transportation difficulties have impeded the flow of materials between the two dominions. Indian oilseeds remain high priced, in the face of the world decline of copra prices, largely because of domestic demand; the part of the total supply exported is much smaller than before the war.

That the Indian price level is far out of line with the world price level at the present exchange rates can be seen from the following comparisons. With 1937 a year in which agricultural prices were higher than in 1939, taken as 100, the Indian wholesale price index in December 1948 was 359, while the United States wholesale price index, in terms of rupees at an altered exchange rate, was 231.[1] The wholesale price index of the United Kingdom was 203. High prices and costs in India tend to encourage imports, as can be seen from the sharp rise in imports from the sterling area following relaxation of controls late in 1948. High prices and costs are probably also limiting India's exports, both directly and indirectly by encouraging the sale of exportable products at home.

Money Supply

The total effective money supply in India and Pakistan[2] at the end of 194 was approximately 22.2 billion rupees ($6.7 billion), showing an increase of over 5 times since prewar (March 1939).

The composition of the money supply in 1947 and 1948 was fairly constant, with demand deposits varying between 35 and 38 per cent of the total. Over the longer term there has been an increasing acceptance into common use of checking deposits; these had been only 30 per cent of the money supply in 1939.

From the end of 1946 to the end of 1948 the total money supply of India an Pakistan increased only 5 per cent. During the first half of 1947 and again in the second half of 1948 the money supply decreased, but there was a 10 per cent increase between June 30, 1947 and June 30, 1948.

1/ The index as computed on a 1926 base was 162. Shifted to the 1937 base it was 188. This has been adjusted upwards in proportion to the shift in the exchange rate between the dollar and sterling between 1937 and the present.

2/ Demand deposits and currency, exclusive of deposits of governments and commercial banks at the Reserve Bank of India and State Bank of Pakistan.

Table II gives some evidence of the major factors responsible for changes in the money supply. The most important was Government deficit expenditures, which were financed in part by the deposits of the Central Government of India at the Reserve Bank of India. Also, throughout these two years the Reserve Bank of India, in pursuance of its policy of maintaining easy money conditions, was adding to its holdings of Government securities, thereby creating additional public holdings of deposits and currency and/or cash reserves of the commercial banks. On the other hand the passive balance of external payments, associated with India's use of its accumulated sterling balances, tended to reduce public money holdings and bank reserves. The net effect of the factors so far mentioned was expansionary throughout 1947 and the first half of 1948. During most of 1947, however, this expansionary effect was more than offset by the contraction of commercial bank credit. Subsequently there was a sharp expansion of commercial bank earning assets, set in motion by the rise in wholesale prices following decontrol. Speculative motives as well as actual needs for additional working capital doubtless played a part in the demand for bank loans. This expansion of bank credit, occurring at a time when the Government's cash balances were declining and the Reserve Bank of India was adding to its investments, was responsible for the sharp growth in the money supply up to about the middle of 1948.

In the latter part of 1948 the decline in commercial bank loans and investments was resumed. The postponement of Government expenditures for development and reform projects, under the anti-inflation program, enabled the Government of India greatly to reduce the drain on its cash balances. Finally, the relaxation of import and exchange controls for non-dollar transactions (in September 1948) tended to enlarge the external deficit and to drain off rupee money holdings. In the latter half of 1948 the combination of these factors resulted in a moderate contraction of the money supply.

Money, Capital and Bullion Markets

The money, capital and bullion markets during 1947 and 1948 all showed effects of the insecurity felt in India following partition, and the uncertainty which prevailed as to the Government's economic policies. The commercial banks -- which, with the Reserve Bank of India, constitute the modern sector of the Indian money market -- have been contracting credit, except during the phase of sharply rising prices in 1947-48. Interest rates in this money market remained stable. The Reserve Bank of India and the Treasury followed a policy of maintaining cheap money but did not cheapen it further. The Reserve Bank of India rediscount rate has not varied from 3 per cent since 1935. The yield on 3-month Treasury Bills rose above its customary 1/2 per cent only in the latter part of 1948. The decline in the price of Government of India bonds raised their yield slightly above 3 per cent, though the coupon rate is 2 1/2-2 3/4 per cent on recent flotations. The rate on advances by the Imperial Bank (the largest commercial bank) remained at 3 1/2 per cent.

Operations of the modern sector of the money market, however, do not extend much beyond urban commercial and Government financing. The greater part of agricultural and inland trade financing is done by the indigenous sector of the money market, composed of local money-lenders and merchants, whose interest rates are normally usurious. Efforts have been made by the Government in the postwar period to expand modern financing facilities to the small borrower or saver by support of the cooperative banks, land mortgage banks, and the Postal Savings Bank. Through these efforts the Government hopes also to narrow the gap between the two sectors of the money market and to promote the mobilization of the savings of the

TABLE II

Money Supply in India and Pakistan
(In billion rupees)

	Dec 27 1946	June 27 1947	June 25 1948	Dec 31 1948
Total Effective Money Supply 1/	21.17	20.62	22.70	22.21
Demand deposits 2/	7.80	7.26	8.46	8.34
Currency outside banks	13.37	13.36	14.22	13.87

	1st half 1947	July '47 - June '48	2nd half 1948
Changes in Total Effective Money Supply 1/	-.55	+2.08	-.49
Changes in Related Banking & Monetary Items			
1. Rupee coin issue 3/	+.05	+.04	+.01 3/
Reserve bank 4/ assets:			
2. Gold and foreign exchange	-.51	-.36	-.67 5/
3. Loans and investments	+.31	+.49	+.34 5/
4. Misc. assets minus liabilities 6/	-.25	-.01	+.02
Scheduled bank assets:			
5. Advances and bills	-.36	+.56	-.04
6. Misc. assets 7/	-.37	+.35	-.13
A. Net total increase in items 1-6	-1.13	+1.07	-.47
7. Deposits of govts. at reserve banks	-.64	-1.00	+.25 8/
8. Time liabilities of scheduled banks	+.15	-.16	-.16
B. Net total increase in items 7 & 8	-.49	-1.16	+.09
C. Increase in A minus increase in B	-.64	+2.23	-.56
D. Residual unaccounted for 9/	+.09	-.15	+.07
E. Increase in total effective money supply	-.55	+2.08	-.49

1/ As computed and published by Eastern Economist.
2/ Excluding deposits of governments and banks at reserve banks.
3/ Including rupee coin (and 1-rupee notes) held by reserve banks. Excludes Pakistan coin in circulation outside reserve banks (figures not available).
4/ Reserve Bank of India, and State Bank of Pakistan, in 2nd half 1948.
5/ Excluding 2.84 billion rupees decrease in sterling balances (with a corresponding increase in Government of India securities issued to the Reserve Bank of India) in connection with the settlement with the U.K. under the Agreement of July 9, 1948.
6/ i.e., liabilities other than deposits.
7/ Computed by deducting change in sum of advances, bills, cash and deposits at reserve banks from change in sum of demand and time liabilities.
8/ Including -.10 for deposits of Central Government of India and +.31 for deposits of Central Government of Pakistan.
9/ Represents difference between changes in effective money supply as computed by Eastern Economist and net effect of changes in items shown in table. Probably includes changes in assets of nonscheduled banks and (in second half of 1948) in Pakistan coin in circulation.

larger part of the population -- savings which at present are devoted to the purchase of land or to additions to hoards -- for more efficient use in both public and private financing.

The bullion market in 1948 was characterized by a rise in prices which brought gold to over 2 1/2 times the U.S. price, and silver to almost double the U.S. price. Licenses for the import of precious metals have not been issued since March 1947. The import ban, the generally high level of prices, insecurity, and the general predilection for precious metals for both investment and ornamentation, are sufficient to explain these high prices.

1948 was a poor year for the stock exchanges. An index number of ten sensitive shares on the Bombay stock exchange fell from 100 at the beginning of the year to 68 at the end. Rising commodity and bullion prices thus coincided with falling stock prices. Moreover, official consents for new capital issues showed a decline from 1947 figures. This depression in the securities market has been ascribed to the Government's programs for nationalization of industries; to dividend limitations and other controls; and to uncertainties on both the national and international scene. The Government has taken several steps to remedy this situation. In addition to repeated attempts to conciliate the business community, the nationalization program has been slowed down, and tax relief has been granted to business. An Industrial Finance Corporation, owned by the Government, the Reserve Bank of India, the scheduled banks, insurance companies and other institutional investors, began operating on July 1, 1948, with the purpose of making loans and advances to industrial concerns. On June 1, 1948, the Rehabilitation Finance Administration was set up by the Government to aid refugees, displaced by the partition, who needed loans for industrial and business purposes.

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THE SPANISH ECONOMY - II. INTERNAL MONETARY DEVELOPMENTS, FOREIGN TRADE AND EXCHANGE

Robert Solomon and
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A. Internal Financial Situation

Spain has been suffering from inflation since the outbreak of the Civil War. According to unofficial statistics 1/the price level in 1935 was close to the average for the period 1922 = 26. From 1935 to 1940, however, the cost of living index increased from 98 to 241 (1922-26 = 100). From 1940 to 1945 the index rose by only 33 percent, from 241 to 321, but since then it has risen to about 570.

The inflationary pressures, already fed by large budget deficits, were increased markedly in 1945 as a result of a severe drought and the poorest harvest of the century on record. Prices rose rapidly during the second half of 1945 and continued to rise throughout 1946.

Although in 1946 the harvest was more plentiful, supplies of electricity were greater, and the budget deficit was reduced somewhat, a wave of speculative activity carried prices forward at a rapid rate. A series of strikes, which are illegal in Spain, occurred during that year, presumably in protest against the rapidly rising cost of living. The government took steps to eliminate black marketing activities, but the result was apparently a more rapid spurt in illegal prices. During the same year a series of government regulations authorized wage increases in the principal industries. The speculative activity occurred not only in commodities but also in the real estate and stock markets where it was financed to a great extent by bank credit.

The continued budget deficits, although declining, sustained the inflationary pressures. The following table indicates the evolution of the budget since 1944: 2/

(In millions of pesetas)

Year	Receipts	Ordinary expenditure	Extraordinary expenditure	Total expenditure	Deficit
1944	10,330	10,360	2,933	13,293	2,963
1945	10,545	10,651	2,584	13,235	2,690
1946	11,128	11,322	1,917	13,239	2,111
1947	12,964	14,223	None	17,233	1,269
1948	15,115	15,196	None	15,196	81 3/
1949	16,743	16,782	None	16,782	39

1/ Published by the Superior Council of Chambers of Commerce, Industry and Navigation, in Madrid. The official statistics use 1936, a civil-war year, as base. It should be emphasized that none of the indexes take adequate account of black market prices.

2/ From Embassy report No. 23 (Annual Economic Review for 1947) Madrid, February 17, 1948.

3/ According to the Embassy report for 1948, deficit appropriations are estimated at 984 million pesetas for 1948.

While prices continued to rise during 1947, the rate of increase was less than in 1946 and the general inflationary psychology subsided considerably. In fact there was small seasonal decline in food prices during the spring of the year. The stock market broke sharply at that time and, except for a small rise in the autumn of 1947, has followed a steady decline. Likewise the real estate boom reached its end during 1947 and, new construction fell off sharply. 1/

These developments were accentuated by the government's effort, beginning in the last quarter of 1947, to restrict the expansion of bank credit. In November the Bank of Spain's discount rate was raised from 4 to 4.5 percent and the commercial banks were requested to follow a stricter credit policy and, in fact, to reduce the volume of private credit outstanding, while increasing their holdings of government securities.

There was another decrease of food prices during the spring of 1948, which began earlier and was of greater magnitude than the decline of 1947. Black market prices fell sharply during the second quarter of the year, according to reports. During the summer the decline was arrested and prices began to increase again, though not as rapidly as during previous years.

The money supply, which had increased by 2.5 billion in 1945, 7.7 billion in 1946, and 6.6 billion in 1947, was in September 1948 only 2.8 billion pesetas above the level of September 1947. Corresponding to this evolution of the money supply, the rate of expansion of bank credit, both by the Bank of Spain and the commercial banks declined sharply in 1948.

The credit restrictions appear to have put many firms in a tight position and forced liquidation of inventories which had been accumulated at high black market prices. It has been estimated that black market prices reached a peak in late 1946 and that their 1947 average was about 10 percent below the previous year's average; the 1948 level is estimated at around 15 percent below 1947 although they began to increase again in late 1948. 2/

While inflationary pressures slackened during 1948 along with some decline in business activity it is difficult, from available information, to assess the extent or even the causes of this development. While the credit restrictions have apparently contributed to the weakening of inflationary pressures, it appears that they were applied after the main inflationary pressures had spent themselves; this is indicated by the breaks in the stock and real estate markets. It should also be noted that the budget deficit has been declining since 1946 and that the import surplus has increased somewhat over the past three years. On the whole, however, inflation has been arrested not because of particularly effective anti-inflationary action by the Government, not certainly because the supply of goods has markedly increased.

It appears that, on the contrary, the continued inability of Spain to obtain substantial amounts of raw materials and equipment from abroad

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1/See this Review, June 7, 1949.
2/Annual Review for 1948, Embassy Report 37, February 14, 1949.

has dampened investment and depressed expectations in general. The absence of strong inflationary pressures during the past year thus is a sign of resignation to continued stagnation rather than of equilibrium attained through expansion in output. Conversely, should Spain be given economic aid on a scale at all commensurate to that available to other Western European economies, inflation might well receive a renewed impetus since business and investment activity probably would be stimulated far more than warranted by the additional resources available from abroad.

B. Foreign Trade

With the exception of the periods during the two world wars, Spain has traditionally had an import surplus. Strict regulation of foreign trade has been practiced since the end of the Civil War with the purpose of utilizing the limited foreign exchange earnings for essential imports such as fertilizer, basic raw materials, and agricultural and industrial equipment. However, as a result of the decline in agricultural production Spain has been forced to import large quantities of wheat and other food items at the expense of imports necessary for economic development.

Before the Civil War much of Spain's trade was with the industrial nations of Europe and the Western Hemisphere. Agricultural items amounted to ov 60 percent of the total value of exports, especially fruits and vegetables, fish, wine, olives, and olive oil. In addition, minerals and chemical products were important exports. The United Kingdom ranked first as a market for Spanish food and minerals, taking 22 per cent of total Spanish Exports in 1945. Germany and the United States accounted for 13 and 10 percent, respectively. Spain's imports consisted mainly of machinery and vehicles, raw cotton, fertilizers, and other chemical products and high-grade coal. The United States, Germany, and the United Kingdom were also Spain's main suppliers, furnishing 17 percent, 14 percent, and 11 percent, respectively, in 1935.

As has been indicated previously, the destruction of the Civil War and the isolation of the World War years caused a serious decline in Spanish production. As a result the volume of Spanish exports has decreased sharply since before the Civil War. In 1947 the volume of exports, as measured by weight, was only 53 percent of the 1935 level.

The outstanding change in the pattern of Spain's foreign trade since before the Civil War has been the large growth of food - especially cereal - imports. This change is reflected in the altered geographical pattern of Spain's foreign trade. Argentina has become Spain's principal supplier, accounting for 28 percent of imports in 1948, whereas in 1935 Argentina had furnished only 2.5 percent of Spain's imports. The Spanish colonies, from which large quantities of food are also imported, have moved up to become Spain's second most important supplier, furnishing 19 percent of imports in 1947. In addition, Spain has in recent years turned to Brazil for raw cotton and tobacco, in an effort to limit her deficit with the United States. While the United States has fallen to third place among exporters to Spain, after Argentina and the colonies, imports from Germany and France have become almost negligible. Thus there has been a shift in Spanish purchases away from the industrial countries toward Argentina, Brazil, and the Spanish colonies.

The main changes in the Spanish export picture have been an increase in the importance of cotton manufactures and chemicals since 1935, increased trade with the Spanish colonies, and the loss of German and French markets since the end of World War II. Almost a third of total exports were shipped to the colonies in 1947 compared with 4 percent in 1935, the principal items being wine, vegetables, cotton textiles, and chemical products. Germany and France, which ranked third and fourth as export markets in the pre-Civil War period, now receive a negligible amount of goods from Spain while the United Kingdom has dropped to second place, after the colonies, as a market for Spanish exports. Up to the present, exports to Argentina have not increased significantly. Spain's large trade deficit with Argentina is being financed by Argentine credits, under the so-called Franco-Peron agreement.

It may be seen from the table that, since before the Civil War, the geographical structure of Spain's foreign trade has changed considerably, reflecting the economic deterioration and the necessity to concentrate imports on basic foods and raw materials. Thus in most cases Spain has reduced a pre-Civil War deficit (or increased a surplus) with the more industrialized countries, while increasing its deficit with the so-called primary-producing areas. A notable exception to this generalization is trade with the Spanish colonies which now shows a surplus. While the reasons for the latter development are not entirely clear, it is probable that Spanish exports have encountere less price resistance in its own colonies than in foreign countries.

C. Exchange Rate and Exchange Controls

While the low level of production is primarily responsible for the lagging exports, the high prices of Spanish industrial and agricultural products have acted as a deterrent to exports. Prices have risen over five times since 1935, but the official exchange rate has changed from about 7.3 pesetas per dollar in 1935 to only 10.95 pesetas at present. Purchasing power parity calculations indicate so crass an overvaluation of the peseta that, in this case, these calculations must be accorded some significance.

Nevertheless, the Spanish Government has persistently avoided an outright depreciation, although it has adopted many expedients which are equivalent to partial depreciation.

The present exchange rate (official buying rate of 10.95 pesetas per dollar) was established in 1941. A preferential tourist rate, which existed before the war, was again established in 1946, at a level of 16.40 pesetas per dollar.

In January 1949 this rate was lowered to 25 pesetas and, as regards U. S. dollars, pounds sterling, Swiss francs, Belgian francs and Portuguese escudos, was made applicable also to capital repatriation, emigrant remittances, and transfer of earnings on foreign capital in Spain. At the same time the old tourist rate of 16.40 pesetas was established as a special rate for capital imports and shipping expenditures. While the official rate was not altered, a series of special differential rates were announced by the Foreign Exchange Institute for particular groups of commodities. As regards imported goods

SPANISH FOREIGN TRADE, 1935, 1946, 1947, 1948
(In Millions of U.S. Dollars)

	Imports				Exports				Trade Balance			
	1935	1946	1947	1948 1/	1935	1946	1947	1948 1/	1935	1946	1947	1948 1/
United States	48.35	52.92	34.96	30.38	18.29	52.17	24.83	32.34	-30.06	-.75	-10.13	+1.96
Argentina	7.19	30.06	84.61	125.45	10.45	6.74	15.03	8.49	+3.26	-23.32	-69.58	-116.96
Brazil	1.63	24.83	33.00	34.63	1.31	3.29	3.59	3.92	-.32	-21.54	-29.41	-30.71
Other Western Hemisphere	19.93	33.98	30.38	n.a.	12.42	16.81	21.91	n.a.	-7.51	-17.17	-8.47	n.a.
Sub Total	77.10	141.79	182.95	n.a.	42.47	79.00	65.36	n.a.	-34.63	-62.79	-117.59	n.a.
United Kingdom	30.38	25.48	25.16	n.a.	41.82	38.91	42.31	n.a.	+11.44	+13.43	+17.15	n.a.
Other Sterling Area	17.64	8.82	26.79	n.a.	1.63	2.39	7.08	n.a.	-16.01	-6.43	-19.71	n.a.
Sub Total	48.02	34.30	51.95	n.a.	43.45	41.30	49.39	n.a.	-4.57	+7.00	-2.56	n.a.
France	16.00	1.63	.32	1.96	22.54	1.22	neg.	10.78	+6.54	-.41	-.32	+8.82
Germany	39.20	.65	.65	neg.	24.50	.33	1.26	2.61	-14.70	-.32	+.61	+2.61
Other ECA countries	56.09	47.70	52.39	n.a.	42.47	58.80	78.41	n.a.	-13.62	+11.10	+26.02	n.a.
Colonial possessions of ECA countries (except UK)	9.47	19.72	12.91	n.a.	1.96	.33	3.04	n.a.	-7.51	-19.39	-9.87	n.a.
Sub Total	120.76	69.70	66.27	n.a.	91.47	60.08	82.71	n.a.	-29.24	-9.02	+16.44	n.a.
Other foreign countries	29.73	2.97	19.60	n.a.	6.21	5.23	14.04	n.a.	-23.52	+2.26	-5.56	n.a.
Total foreign countries	275.61	248.76	320.77	n.a.	183.60	186.21	211.50	n.a.	-92.01	-62.55	-109.27	n.a.
Spanish colonies	11.56	52.78	75.84	n.a.	8.50	79.39	94.94	n.a.	-3.06	+26.61	+19.10	n.a.
Total, all countries	287.17	301.54	396.61	445.29	192.10	265.60	306.44	321.80	-95.07	-35.94	-90.17	-123.49

1/ January-November

Source: Estadistica del Comercio Exterior de Espana, 1935, 1946, 1947.
Spain, Annual Economic Report, 1948, American Embassy, Madrid, February 14, 1949, No. 37.
Source data are in gold pesetas and have been converted to dollars at rate of 32.67 cents = 1 gold peseta.

these rates vary between 11.22 and 27.38 pesetas per dollar according to the extent to which they are considered essential to the Spanish economy. For exports, the rates vary from 10.65 to 21.90 pesetas, presumably according to the extent to which Spanish prices for the particular commodities are out of line with world market prices. Commodities for which no special rate is set will continue to be imported and exported at the official rate. It may be noted that the free market peseta rate for the dollar on the active Tangiers market has fluctuated over the past few months between 37 and 38 pesetas per dollar.

Although the system of differential exchange rates for merchandise trade was announced in December, recent reports from Madrid indicate that, at least as regards exports, it has not yet been put into effect. Exporters are still paid 10.95 pesetas per dollar for all merchandise exports; the difference between this rate and the special rates is apparently to be treated as a deferred claim by the exporter, to be paid when the Foreign Exchange Institute will have sufficient pesetas from premium-rate imports. 1/

While the announcement of special differential rates is the furthest the Spanish Government has gone in the direction of an outright devaluation of the peseta, there had been earlier departures, aside from the special rates for tourist and other non-merchandise transactions, from a unitary exchange rate. These modifications, which may have been inspired by the Italian system, were an attempt to make merchandise exports and capital imports more attractive without an outright devaluation. For at least some products, exporters were permitted to retain a portion (for example, 28 percent in the case of almonds) of their foreign exchange proceeds and either to sell them to importers of approved products (at any rate privately agreed) or to import approved goods, the sale of which would presumably permit them to increase their earnings. In addition, as in the Italian franco valuta system, "imports without exchange" of certain commodities were permitted to be financed through funds held abroad. Also, a bonus and tax system was used in which exporters of certain goods, for example olives, were paid a premium over and above the official rate, while certain imports were taxed in order to raise their peseta price and, incidentally, to provide the funds for the premia on exports.

These various departures from a unitary exchange rate, especially the latest somewhat cumbersome system of differential rates, indicate that the Spanish authorities are well aware of the need for depreciation but are reluctant to impair the "prestige" of the peseta by an outright devaluation. It would appear, however, that such expedients do not, to say the least, impart any further prestige to the currency. Moreover, they are likely to give rise to expectations of further depreciation. It would also seem that such a complicated system presents opportunities for many types of fradulent transactions and corrupt practices.

While a straightforward devaluation together with the reestablishment of a unitary exchange rate would undoubtedly provide a much needed fillip to exports an expansion of exports adequate to finance an augmented flow of essential imports must rest on basic increases in capital formation and productivity.

1/ Foreign Commerce Weekly, May 2, 1949, page 25.

D. Balance of Payments

As far as can be discovered the only Spanish balance of payments data available are those for 1931 and 1932, published by the League of Nations in its Balance of Payments Yearbook for 1933. In 1931 a deficit in merchandise trade of about 260 million gold pesetas 1/ was offset, to the extent of about 160 million gold pesetas, by invisible earnings. The largest of these invisible receipts consisted of emigrants' remittances. In addition there were smaller net receipts deriving from Spanish shipping and foreign investments. The current account deficit of about 100 million gold pesetas was financed almost entirely by an inflow of short-term capital, presumably representing the utilization of Spanish short-term balances abroad.

It is indicative of the deterioration of the Spanish economy that the value of merchandise imports and exports, expressed in gold pesetas, was roughly the same in 1947 as it had been in 1931, despite the great rise in world prices. While there is no information available on invisible earnings, it would appear that these have declined, even in value terms, since before the Civil War. This conclusion is indicated by the fact that 77 percent of the merchandise trade deficit in 1947, accounted for by trade with Argentina, was probably financed by the Argentine credit. 2/ Since it is reasonably certain that Spain is not accumulating foreign exchange reserves or extending credits abroad, it must be concluded that invisible earnings have declined or that a substantial capital flight is occurring.

The agreement with Argentina which provided a $100 3/ million credit to Spain in the autumn of 1946, was extended in April 1948 by the Franco-Peron protocol. At that time an additional $400 million credit to be utilized over a four-year period was promised to Spain. The first $100 million credit was completely utilized during the period between the two above-mentioned agreements. The size of the deficit with Argentina during 1948 indicates that Spain has taken advantage of the clause in the Franco Peron Protocol permitting utilization of more than one-fourth of the $400 million loan during the first year.

It is not known how the substantial trade deficit with Brazil is being financed.

The only known dollar credit which Spain has received is the recent gold loan from the Chase National Bank. This will permit an increase in Spanish imports from the United States after the sharp reduction which has occurred in these imports since 1946.

Recent discussions of a Spanish representative with the Export-Import Bank, after the U. S. Government announced that it would not oppose an approach by Spain to that institution, did not yield any positive results, although

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1/ One gold peseta = 32.67 cents now. Before the United States devaluation in 1933, 1 gold peseta = 19.30 cents.

2/ According to preliminary trade returns for the first eleven months of 1948, 95 percent of the net merchandise deficit resulted from trade with Argentina.

3/ The dollar (and peseta) equivalents of the Argentine loans have been derived assuming that the "basic" Argentine export rate is appropriate for Spanish purchases in Argentina.

the door was not closed to a resumption of negotiations.

In view of Spain's rather restrictive and arbitrary treatment of foreign capital, it is not likely, under present circumstances, that investments from abroad will occur on any substantial scale. There have, however, been isolated instances such as the recent $8 million investment by the California Texas Company in the Cartagena oil refinery. A major American investment in Spain was liquidated in 1945 when the Spanish Government purchased the Spanish Telephone Company, a subsidiary of the International Telephone and Telegraph Company. The Spanish Government agreed to give $50 million of dollar bonds to International Telephone and Telegraph in partial payment for this purchase and to pay each year as interest and amortization on these bonds at least 20 percent of Spanish dollar earnings from exports to the United States. This obligation has been paid regularly and the debt now amounts to $19 million.

According to recent reports from Europe, consideration has been given in both France and Belgium to the extension of credits to finance the export of equipment to Spain. As far as is known there have been no European credits given to Spain. However, as other European countries continue to recover and the competition for export markets becomes intensified, it is possible that some loans will be forthcoming from Western Europe.

An examination of Spain's balance of payments situation reinforces the earlier observations concerning the relative stagnation of the Spanish economy. Just as the weakening of the inflationary pressures in Spain do not indicate a fundamental recovery as a result of increased supplies of goods, the absence of a large import surplus does not mean that Spain's external economic problems have been met. In fact, expectations of substantial foreign aid, by stimulating investment, might very well result in greater pressure on Spain's balance of payments than now exists.