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January 2, 1951

IBRD REPORT ON A DEVELOPMENT PROGRAM FOR COLOMBIA: A PARTIAL AND PRELIMINARY APPRAISAL

Gerald M. Alter

Publication by the IBRD of "The Basis of a Development Program for Colombia" represents a landmark in the current efforts of the International Bank and its members to establish a broad framework for future collaboration. This comprehensive report prepared by a thirteen-man Mission headed by Lauchlin Currie was designed as a working paper for the formulation of a development program to raise the standard of living of the Colombian people. Now under formal consideration by the Bank's own staff and by a bi-partisan special Committee appointed by the President of Colombia, the report is likely to play an important role in Colombia's future development policy. As the first comprehensive report outlining an economic development program prepared under the auspices of the International Bank, it may also influence the nature of economic development programming among many of the underdeveloped countries.

The comprehensive report contains over 600 pages; a summary report of 76 pages has been prepared in pamphlet form and 10 technical appendices constituting about 150 pages have been made available. The outcome of nearly a year's work by the Mission, the comprehensive report covers a wide array of topics under two parts—"first, a description and diagnosis of economic conditions and problems in the various fields discussed and, second, proposed measures for improvement and estimates of financial and other requirements to carry them out." Under Part I, <u>The Problem</u>, the first four chapters are devoted to a general description and analysis of the Colombian economy, as indicated by chapter titles, The Country and the People, Factors Accounting for the Standard of Living, National Income and Product, Capital Formation. The next nine chapters analyze problems in specific sectors, including Agriculture, Industry and Fuels, Surface Transport, Air Transport, Health and Welfare, Electric Power and Community Facilities, Housing, and Education and Training. The last five chapters of Part I cover the internal financial situation, the international economic position of Colombia, and the country's organization for Planning and Administrations. Part II, <u>The Program</u>, is developed along lines which follow for the most part the sector headings of Part I. The final chapter, The Over-all Program and its Implementation, attempts to appraise the feasibility of the capital investment program developed in the sector analysis, to assess some of the effects of the total program, and to indicate the lines along which implementation should proceed.

As a pioneering work designed to provide a broad framework for a Colombian development program, the Comprehensive Report accomplishes its basic purpose. Although there are many sections of the report which serve merely to illustrate the considerations which must enter into the formulation of such a framework, the mission has carried its job to a point where the fruits of continuing effort along the same lines can be clearly anticipated. From the point of view of the International Bank, decisions as to its own operations in Colombia can be based on a continuing appraisal of the steps which Colombia takes to formulate and implement a soundly conceived program along the lines suggested. From the point of view of the Colombian Government, the report represents a veritable textbook of economic policy, careful study of which can be expected to help sustain a high rate of economic progress and a more equitable distribution of the fruits of such progress.

The program as developed in Part II of the Comprehensive Report covers a wide variety of actions and policies designed to raise the standard of living and production efficiency and to distribute gains more widely. While stressing the desirability of a well-integrated investment program, the mission gives due recognition to all kinds of practices and policies, both in the private and public sectors, constituting correctible sources of weaknesses in the development effort. Though stressing the advantages to be gained from simultaneous improvements throughout the economy, the mission denies any intention to suggest that a radically new and different economic order be adopted by Colombia. On the contrary, the intention is rather "to modify an existing situation, to shift the emphasis somewhat, to suggest a multitude of improvements and reforms."

The need to place main reliance on the utilization of domestic resources is forcefully presented. The extent to which foreign capital may be available is uncertain, the mission observes, and in Colombia's case "substantial capital has been invested in the past and the current annual volume of /domestic7 saving is much greater than would reasonably be expected yearly from abroad." Taking this point of view the mission anticipates that with a total investment (both private and public) of Ps. 1 billion per year over a five-year period, only 60 million per year or 6 per cent would be financed from abroad. 1/ The low volume of net capital inflow into Colombia projected by the mission, based it should be noted on pre-Korean assumptions, is not predicated on any explicit analysis of Colombia's long-term capacity to service foreign investment, as it might be improved by executing a program following the mission's recommendation. In this area the mission apparently faced a dilemma. By deciding to focus on a five-year period (1950-55) because "this was the minimum in which it would be possible to show results and yet not so long as to make calculations too highly speculative," the mission eschewed the longer run analysis which is an essential ingredient of a full appraisal of the capacity of an underdeveloped country to assume the

1/ It is interesting to note that in the pre-World War I period Canada enjoyed a level of capital inflows equivalent to about one-half of capital investment, according to the Royal Commission of Dominion-Provincial Relations.

burden of additional foreign debt. 1/ Since, however, such an analysis might have no appreciable effect on the amount of foreign capital actually forthcoming, it can be argued that the best assurance to Colombia of increased capital inflows would be gained from an immediate and actual demonstration of accelerated economic progress.

In fact, however, the mission does not claim, despite the advantages which it sees in a comprehensive program, that the recommended program would secure a rate of increase in productivity in advance of that prevailing between 1939 and 1947. This is due perhaps in part to the rapid increase which the mission's analysis revealed as having already occurred--an average increase of almost 3 per cent per capita. Continuation of approximately this rate of increase, would represent no mean achievement. 2/

The confidence of the mission in a continued rapid advance in productivity is based on several factors: (1) the fact that the economic base is very low to start with makes possible a high percentage rate of increase; (2) Colombia can take advantage of nearly two centuries of development of machines and techniques abroad; (3) Colombia has a highly favorable position with regard to the basic sources of power--coal, oil, gas, and hydroelectric potential; (4) Colombia possesses a vigorous and well-educated leadership in government, the professions, industry, and agriculture. While these considerations may justify considerable optimism, the mission itself recognizes many handicaps to a rapid rate of development, one of the most important being the effect of Colombia's topography on transportation. Development of a national market is greatly hindered by trisection of the country by three lofty and continuous mountain ranges. Although the natural obstacles are fully recognized by the mission, many of its recommendations being designed to surmount or minimize them, it should be recognized that the projection of an average increase of about 3 per cent per capita in productivity is not and perhaps cannot, with present analytical techniques, be rigorously supported. The scarce statistical materials on the Colombian economy, exploited imaginatively and brilliantly by the mission, permit, as the mission itself admits, little more than a "demonstration model". The effects of specific investment projects and improved techniques in such fields as transportation, power, community facilities, health and welfare on the over-all situation were not and probably could not be fully worked out by the mission, given the time available to it and the limited preparatory work

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1/ See this Review, October 10, 1950, Economic Development and the Capacity to Service Foreign Investments.

2/ The Council of Economic Advisers estimated in January of 1950 that the U. S. should be able to increase productivity per fully employed worker by 2 to 2.5 per cent annually in coming years.

carried on by the Colombian Government. The mission, when it formulates even the short-term results in quantitative terms, implies perhaps a more precise relationship between its program, past trends, and projected improvements in productivity than actually exists.

The investment program

The mission, showing a keen appreciation of the limits which surround any effort quickly to augment capital investment without greatly increased foreign investment, carefully appraised the total amount of investment which the economy could support and the measures which would have to be devised, particularly in the fiscal and monetary sphere, to ensure implementation of the program while maintaining economic stability. The mission's analysis depends heavily on a tentative set of national accounts and on projections of productivity, employment, prices, government receipts and expenditures, etc. Although the resulting model of the national accounts for the mid-year of the program is subject to many reservations, it serves to support the conclusion that total investment of about 1 billion pesos in 1953 is a practical goal.

The recommended investment program, developed by the mission within these over-all limits and based on an analysis of all the major sectors of the Colombian economy, is summarized in peso and percentage terms in the following table for the mid-year of the program.

Projected Investment Program by End Use, 1953 Compared with Pattern of Capital Formation in 1947

(in millions of pesos and as percentage of total)

	1947		1953	
	millions of Ps.	%	millions of Ps.	%
Industry	103.6	16.9	148.3	14.5
Agriculture	67.8	11.1	103.4	10.3
Transportation	199.0	32.6	304.7	29.9
Mining	21.8	3.6	27.1	2.7
Construction trade	6.6	1.1	8.1	0.8
Housing	123.0	20.0	229.1	22.5
Buildings	39.5	6.4	89.5	8.8
Municipal facilities and power	50.9	8.3	107.3	10.5
Total	612.2	100.0	1017.5	100.0

Source: Comprehensive Report, pages 42, 594, 595.

This program constitutes partly a projection of past trends, partly a reflection of an appraisal of specific projects, and partly the result of an assessment of social and economic priorities. It reflects the judgment of the mission that Colombia should "divert a slightly larger flow of capital to the provision of electric power, community facilities, hospitals, health centers, and low-cost housing than could be expected on the basis of existing trends". In the fields of industry and transport, a relative decline is recommended. In industry, 1947 was an abnormally high year of capital goods imports following reconversion to peace-time production abroad. The relative decline in both industry and transportation is associated also with the mission's recommendation against many projects, including the Paz del Rio Steel Project, being actively promoted by Colombian Government agencies.

Appraisal of the investment program in its broadest terms is difficult by virtue of the fact that the considerations which determined the limits established for each field (see above table) are not clearly stated. 1/ For reasons developed below, it must be concluded that the quantitative investment limits set down by the mission cannot actually be accepted, for each and every field, as targets.

In general, the assessment of relative priorities among the broad sectors of the economy constitutes one of the weakest areas in the whole report, although within particular sectors (transportation, for example) the analysis appears to be excellent. With respect to the allocation of total investment resources among broad sectors of the economy, the deficiency in performance results, it appears, from an improper or over-ambitious formulation of the problem. The mission undertook to develop the limits which should be imposed on investment expenditures in each and every sector (industry, agriculture, transportation, etc.), with no common purpose in mind and in some fields without any apparent rationale. In some fields--housing, for example--a total figure of investment expenditure is arrived at explicitly, in this case by determining construction expenditures required in order to prevent average density of housing occupancy from rising in each of several population groups. In housing, a specific target is thus set up on the basis of clearly stated criteria. In other fields--industry and transportation, for example--there is an assignment of funds to some specific

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1/ Apparent inconsistencies have even crept into the final chapter of the report devoted to the over-all program. For example, at one point (page 595) it is observed of the program that "agriculture, while increasing in absolute terms, continues to decline in relative importance and this may be noted as a long-term and desirable trend". A few pages later (610) it is argued that higher social returns would be yielded by devoting (relatively?) more investment to raising agricultural productivity.

projects based on a careful examination, but total investment resources allocated to these sectors are not based on any explicit rationale. For industry, total investment in the recommended program is Ps. 148 million, of which only 26.1 million results from an analysis of specific projects. The extent of the "unplanned" component is perfectly consistent with the mission's observation that "For the most part we do not seek to substitute our judgment for that of the market place. We assume that a certain pattern and rate of growth will necessitate and justify a substantial volume of investment, particularly in industry and transport." (Page 593). Nevertheless, the mission does appear to indicate target figures for broad sectors. At least with respect to the division of investment expenditures among these sectors, the mission appears to be substituting its judgment for that of the market place. On what is this judgment based? What purpose does it serve? The answer is not clear. For industry, a total of 148 million pesos is recommended "on the basis of the 1947 figure on capital formation." The figure of 148 million pesos actually bears no clear relationship to the 1947 figure.

Thus, although the mission emphasizes that the market place will still allocate a substantial part of investment resources, its formulation of the total investment program by end use, as in the above table, implies that the figure for each field constitutes a target for public and private action. Given the absence of a common rationale for the estimates and the lack of any real justification for the recommended magnitudes in some fields, the investment limits for each sector cannot be accepted as targets, and no other purpose is apparent.

A suggested reformulation

From the viewpoint of establishing objectives for policy purposes in an economy which is not to be completely planned, an investment program might well be formulated along different lines, the detail dependent upon the degree and kind of influence which the government seeks to exert in order to secure its objectives. First, investment expenditures directly under control of the central government authority—with as fine a breakdown by fields or projects as prior analysis might justify; second, investment expenditures by other governmental divisions and autonomous agencies, with as fine a breakdown by fields or projects as prior analysis and the degree of control to be exercised might permit; third, those investment expenditures by non-governmental institutions over which the government would wish to exercise an influence through special financial and other aids offered by government institutions; fourth, other investment expenditures, over which governmental control would be limited to those imposed by general fiscal and credit policies, or to outright prohibition. The fourth area could not be divided into different fields, although if absolute prohibitions were contained in the program, the areas affected could be designated. The figure shown for "other investment" expenditures would represent a target only as a total—it would serve as a guide to those institutions implementing fiscal, monetary, and other indirect controls. The composition of investment in this sector would not constitute a target, although a continuing appraisal of its historical composition would be useful in reappraising the composition and magnitude of the public investment program.

Under this kind of a structure, the assessment of relative priorities is still difficult and, of course, the total volume of permitted investment must still be determined. However, the structure indicates the type of investment priority determinations which, in fact, must be made: (1) within the government or government-influenced sectors, (2) between the government or government-influenced sectors and the private sector where market forces fully determine the composition of investment. Furthermore, a summary formulation of the program in this matter would force a systematic re-examination and possible modification of some of the goals established in particular fields. In economic development programming, specific targets must be designed with a view to many considerations, including the nature of the policy tools available. In some fields, housing, for example, the required investment expenditures appear to have been determined in the Colombia report without reference to control techniques available for fulfilling the goal.

Fortunately, the report already includes some of the elements necessary to fill in such an outline as that presented above. There is, for example, a global breakdown between recommended public and private investment even though no detailed summary is shown for public investment; nor is there a summary in terms of the type and degree of governmental influence to be exercised. The detailed discussion under each sector is sufficient in most cases to permit such a summary, although not in all. (Agriculture is notably weak in this respect.)

The specific recommendations made by the mission with respect to the composition and magnitude of direct government and government-influenced investment expenditures will necessarily be subjected to a careful review by the Colombian authorities. The report is regarded by the mission itself as a first draft of a program, or as a working paper, which should serve as the basis for a definitive program. Disagreements will certainly arise concerning many elements of the program. It has been reported that the mission's recommendations against some specific projects are already the subject of heated controversy in Bogotá. The broad scope of the report should serve to put such controversies in proper perspective.

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Mary Maroney

ISRAEL'S FINANCIAL STRINGENCY

Recent developments in Israel suggest that the country is passing through a time of crisis which is in the main financial. Although agriculture and industry are making substantial progress, the cost of setting up the new State has fast outrun the available resources. Reassessment of the situation has been a feature of most economic reports in 1950 and the indications are that there will be an effort in 1951 to develop financial aid along more comprehensive lines. Press reports indicate that the Government of Israel has planned the flotation of a $500 million, 3½ to 4 per cent bond issue in the United States next May. It is said also that there will be an effort to obtain other forms of financial assistance; from the United States Government in the form of grants and loans, and from private sources through investment in Israeli enterprises. Meanwhile, the Export-Import Bank has just announced the extension of a $35 million credit for agricultural equipment in addition to the $100 million credit advanced in 1949.

Large capital requirements for new immigration

The nature, although perhaps not the extent of the economic problem in Israel, is familiar from frequent presentation. The new State is being developed from a refugee population which is growing rapidly from unlimited immigration of Jews from Europe, Asia and, to a lesser extent, other parts of the world. In the two years since May 1948, 400,000 immigrants have been received. The government expects to take in 200,000 a year for the next three years - i.e., an additional 600,000. This increase would be supplemented by the natural increase in the population already in the country. Altogether by the end of 1953, the population would number 1,800,000 as compared with the 1,250,000 in 1950. In both these figures, a small number of Arabs and other non-Jews is included.

The financing of this unparalleled immigration requires large amounts of foreign funds, because much of the basic equipment on which the country must build has to be imported. The old Palestine was not much of a producer. Although during the war it experienced the beginning of industrialization it remained primarily agricultural and the scale of consumption was low. Israel plans the intensive development of both agriculture and industry - that is, not only the housing and feeding of the immigrants, but the building up of new industries to put them to work. Thus, the task is not solely one of the personal rehabilitation of the immigrants; it is also a matter of the economic development of a land which has quite limited resources. There are various estimates current as to the cost of the planned development per immigrant, ranging from a low of IL 600 ($1,680) to a high of IL 1,000 ($2,800). Taking as a basis a figure of $2,500 which is said to represent the average of experience translated into the current price level, the government believes it could use $1,500 million in the next three years. If two-thirds of this could be raised outside the country, the additional third, it is felt, could be counted on from the local savings which would be generated by the gradually increasing economic activity.

This scale of investment in the country is about twice that which has been available. In his budget speech of May last, the Finance Minister, Mr. Kaplan, referred to productivity as falling short of potential, primarily because of insufficient new investment to provide industries with the proper amounts of raw materials and equipment. He said that whereas a sum of $900 million was required in the preceding two years (April 1948 to March 1950), to meet the requirements of the new immigration, only $335 million had been available. Consequently, jobs were not available for all immigrants and the number in camps increased from 45,000 to 90,000. At the end of October, the number in camps and work villages was still high, about 85,000. In the interim, however an additional 92,000 immigrants had come into the country and presumably 97,000 had been absorbed into its working life.

The shortage of funds in terms of what is needed for optimum employment of the new manpower, however, is not the worst of the State's problems. What has been of more acute concern in 1950 is the approach to exhaustion of the resources which have permitted operations at even the present limited scale. According to some observers, the year end was a period of acute stringency in supplies, caused by the shortage of convertible currencies necessary for foreign purchases. In acknowledgment of the increasing pressure, the Israeli government on December 14 ordered the surrender of title of all U. S. and Canadian securities owned by nationals. This move was expected to add between $7 and $8 million to foreign exchange reserves. It was also expected to assure the world that the assistance being asked abroad is genuinely needed and matched by the sacrifices of Israeli citizens. An interesting feature of the sequestration is that the conversion into Israeli pounds will be made at a premium of 35 per cent for debentures and 33½ per cent for other types of securities.

Balance of payments

As is shown in Table I - the Balance of Payments - the external deficit of the country, estimated at $200 million in 1949, has been covered in the main from three sources: (1) sterling balances derived mostly from Palestine assets taken over when the new State was founded; (2) the $100 million Export-Import Bank loan from the United States in 1949; and (3) donations from Jewish National Funds spent in Israel for the transportation and reception of immigrants, the purchase of agricultural land for them, and like activities. This latter income, which derives from world contributions toward the organization and maintenance of the Zionist state, is by far the largest item of receipts of convertible funds, and it is constantly replenished. The other two items are dwindling assets. The sterling balances which amounted to an estimated £40 million in the middle of 1948, have gradually been reduced, by various steps in unblocking, to about £13 million at the end of October, and the probability is that they will be exhausted in 1951 at the 1950 rate of drawing. The U. S. Export-Import Bank loan made in 1949 is also understood to be fully obligated although it will continue to finance some imports to be received in 1951. Counting the new Export-Import Bank credit of $35 million, the remaining sterling assets which will presumably be unblocked, and the estimated value of the newly requisitioned securities, the amount of foreign exchange available at the beginning of 1951 is apparently of the order of $75 or $80 million.

In terms of the external deficit shown in Table I, this amount of foreign funds would appear to indicate a fairly easy operating position only for the next six to nine months. Interpretation of its significance in exact terms, however is difficult for several reasons. First of all, the official account of the balance of payments for 1949 has not yet been published in final form. While Table I has been compiled from numerous official statements which show considerable information and a general concurrence, they have been invariably incomplete as to details. Thus the amount of the deficit for that year is still subject to revision which would presumably be small but perhaps of some consequence. The figures for 1950 are based on reports of somewhat similar character for eight months which are obviously less dependable.

One of the basic peculiarities of the accounts is the large amount of "no-pay" imports. This is a category which comprehends a considerable variety of transactions presenting no common denominator for estimation purposes. Included are receipts of merchandise which in fact represent transfer of capital. Goods scarcity, and a very high price level in terms of exchange purchasing power, have influenced immigrants as well as investors to endeavor to transfer capital in merchandise rather than funds. In some of these transactions Israeli pounds are reported being purchased for as little as 80 U. S. cents as

Table I

Estimated Balance of Payments
(Millions of dollars)

	1949	1950 Jan.-Aug.	1950 Jan.-Dec. (projected)
Payments			
imports (c.i.f.)	246	188	280
invisibles	15	22	35
	261	210	315
Receipts			
exports	30	not	
invisibles (freight tourism, etc.)	28	available	
	58	42	65
Net	203	168	250
Met by:			
Export Import Bank loan	19	31	45
sterling balances	24	28	40
donations-National Fund	69	45	70
"no pay" imports and barter deals	60	42	65
other credits	32	22	30
	203	168	250

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compared with the official rate of $2.80. Attracting population from all over the world also the new State has had immigration from countries which have objected to making capital transfers in convertible currency. Even in the case of the new population with resources therefore, agreements accepting merchandise in exchange for blocked assets have had to be negotiated. Donations have been made in goods sometimes because it was easier to promote collections for special purposes. Finally, a large amount of shipments between relatives and friends have gone into this category, especially from the United States, and the inclusion of important amounts of such goods as electric refrigerators and automobiles has led to the suspicion that there is some illicit export of Israeli capital. Considering that the country is just beginning to manufacture consumption goods, however, and that it is heavily dependent on the good-will of contributors, there has been difficulty in adhering to a strictly economical pattern of consumption.

Another modifying development which is growing in importance is the actual amount of trade credits granted by a number of European countries, including Sweden, the United Kingdom, France, Switzerland, and Belgium, either to the Israel government or the Jewish National Agency. Most of this is private credit, in some instances guaranteed by the foreign governments, which is tied to the promotion of trade in particular items or groups of items. A total of about $43.5 million has been reported at various times as already arranged. These credits are apparently covered, so far as already used, in the "other credits" category of the balance of payments.

The Four Year Plan

While these circumstances contribute to the possibility of distortion of the external deficit in absolute terms, the preponderance of the evidence is that the country is running a deficit of about $200 million, and that with increasing population this figure cannot be reduced for many years. The "Four Year Plan" authored by Dr. A. L. Gruenbaum, head of the Planning Department of the Prime Minister's Department of Economic Research makes use of this figure. In an input-output study covering the possibilities in the economy on the basis of an immigration increment of about 200,000 each year through 1953, Dr. Gruenbaum has concluded that a foreign investment of no less than $200 million each year will be necessary to put the added population to work. (cf. Table II).

The Gruenbaum figures are based on the assumption that the output of agriculture, which is estimated at $164 million for 1950, can be doubled by 1953 so that there will not only be

Table II

Estimated Required Capital Import

(Millions of dollars)

	1950	1951	1952	1953	Total
Gross investment	351	417	521	602	1,891
Gross investment in foreign currency (difference between imports and exports)	221	213	225	203	862
Gross investment in local currency	130	204	296	399	1,029
National Income	849	1,033	1,203	1,371	
Imports	292	315	360	382	
Exports	71	102	135	178	
from agriculture	17	20	25	28	
" industry	26	37	48	62	
" transportation	17	27	36	50	
" other	11	19	27	38	

Source: Compiled from data published in Business Digest of June 15 and 22, 1950.

self-sufficiency in all foods except meat and cereals, but also a greatly increased production of vegetables, flowers and fruits for export. Industrial production would be increased about 60 percent from a value of $517 to $823 million.[1] Transportation activity would also be trebled and become an important source of foreign exchange income. Whether the degree of expansion can be achieved has, of course, to be demonstrated. Many new factories have begun operations within the last two years and they show an interesting variety of output. In addition to food products, clothing, and shoes, production now extends to electric appliances, radios, plastics, rubber tires, automobile, truck, and refrigerator assembly, cut diamonds and artificial teeth. Many metal by-products are being fabricated. A steel rolling mill is planned, as well as the development of a large chemical industry based on the Dead Sea potash. This latter project, which is of key importance to the country because it would provide fertilizer, has suffered long delay because of the political background of relations with the neighboring Arabs. It was being operated on a limited scale before the outbreak of the hostilities which set up Israel, but since then has been at a standstill because the sweet water supply and the development of adequate transportation depend on the cooperation of the Hashemite Kingdom of Jordan. The hostility of Arab sentiment has also made it impossible for the country to profit from its physical proximity to the enormous petroleum production of the Middle East. The Haifa refinery, which was built to connect by pipeline with Iraq fields has been cut off and the scale of operations reduced to about 20 percent of the original 4 million ton annual capacity, or about that which is required for local consumption. Crude has to come in from the Caribbean and other relatively distant sources. Fuel costs are correspondingly increased.

The Four-Year Plan for exports does not represent great increases in the basic percentage of production allotted to exports but as compared to the current export, it means very large expansion. In 1949, the total export amounted to $28.6 million of which citrus amounted to $18.0 million, fruit juices to $2.4 million, and polished diamonds to $5.2 million. The remaining $5 million was scattered over many smaller items, including drugs, essential oils, wines, chocolates and sweets, artificial teeth, etc., none of which amounted to as much as $1 million. In the target export for 1953, polished diamonds are estimated at $17 million, products of the projected chemical industry at $11 million, processed food at $12 million, and textiles and clothing together, at another $12 million. Whereas most of the current export is directed to the United Kingdom, Western Europe and the United States, the natural markets in the surrounding areas of the eastern Mediterranean and Asia Minor also

1/ Year end press reports give new estimates for 1950 of $140 million for agriculture and $420 million for industry.

figure prominently in the estimate of potentialities.

Of even greater significance in the figures, the production will have an important effect on the balance of payments by providing a domestic supply of many goods for which foreign exchange is now being paid out. In 1949, consumer goods constituted 35 per cent of the import valued at $260 million, cif basis. The supplanting of much of this would seem to be well within the range of possibilities. Other components of the 1949 import, however, were raw materials, 32.9 per cent, production tools, building materials and transport goods, 28.6 per cent and fuel, 6.1 per cent. As adjuncts of a greatly enlarged economy it would not appear that these categories would be so amenable to reduction, except in a few lines. Imports would still be large, therefore even if all consumer goods were to disappear from receipts and the domestic supply of manufactures became entirely sufficient for consumption.

Internal finance also strained

In view of the basic poverty of the economy and the tremendous demands of the development program, it is inevitable that there should be a close connection between the balance of payments and internal finance. At this early stage of operations, the revenue-raising potential from both taxation and domestic borrowing is limited. What does not come from foreign sources is not necessarily available from domestic resources, with the result that there is some inflationary spending. Funds are being raised by the issue of currency against long term internal debt in the form of Land Bonds, repayable in 24 half-yearly installments beginning 3½ after years after issue.

To October 30, about IL 33 million of the Land Bonds had been put into the issue department of the Anglo-Palestine Bank. The greater part of the total was deficit financing for the development and defense budgets. However, about IL 12 million was in substitution for the foreign exchange (sterling) cover of the note issue that had been gradually drawn down to meet external payments. The currency reserve requirement was modified in 1949 to admit the Land Bonds to full standing with gold and foreign exchange in the first 50 per cent of the note cover. The other 50 per cent continues, as originally, to consist of Treasury bills, promissory notes or other short term security.

The budget for the current year indicates that further issues of the Land Bonds are scheduled. In 1949-50, total government outlays, which fell somewhat short of the estimates, were just under IL 100 million. Less than half of this sum, or about IL 40 million, was covered from revenues which amounted to approximately I£ 35 million from taxes, plus small income from the post-office, ports, and miscellaneous sources. For the current year, 1950-51, the ordinary and development budgets were estimated in May, when the budget was put down, at I£ 125 million. There was, further, a secret defense budget (in addition to defense expenditures provided for in the ordinary budget)1/ on which apparently I£ 12.5 million was spent in 1949-50. Against this outlay, about I£ 60 million in tax revenue and I£ 10 million from other sources was anticipated, leaving in excess of I£ 65 million (i.e., the development budget plus the defense budget) to be covered by borrowing. This borrowing was apportioned between I£ 20 million from the 1949 United States Export Import Bank loan, I£ 35 million from the issuance of Land Bonds, and I£ 10 million from other internal (public) loans. Through October, about half of the Land Bond authority had been exercised and authority for the internal loan had been set at I£ 17 million.

The development of the note circulation under these circumstances has been as follows:

(Millions of I. £.)

Date	Notes in Circulation	Cover			
		Foreign Exchange	Land Bonds	Treasury Bills and Other	Palestine Currency Board Notes
1948 - Sept. 29	27.4	1.7	-	-	25.6
Dec. 29	30.7	6.8	-	5.0	18.8
1949 - Mar. 30	36.5	19.7	-	10.2	6.6
June 29	41.3	27.7	-	13.3	0.4
Sept. 28	46.1	25.4	5.1	15.2	0.3
Dec. 28	50.1	28.4	16.7	4.7	0.3
1950 - Mar. 29	55.0	27.5	16.7	10.5	0.3
June 28	56.4	22.6	21.8	11.8	0.2
Sept. 29	69.7	15.4	29.8	24.4	-
Nov. 1	70.6	13.8	32.8	24.0	-

1/ Defense expenditures in the 1950-51 ordinary budget were put at I£ 15 million, almost double the amount shown for 1949-50. The official reports say that this was intended to finance more of the total military expenditure from the ordinary budget, i.e., a reduction of the secret budget is inferred.

The role of the Land Bonds with respect to the expanding note circulation is the permanent factor in this record. Additionally, there is shown, in the increased accumulation of Treasury bills in the hands of the Issue Department of the Anglo-Palestine Bank during the third quarter of 1950, the reflections of the sharp but short-lived upset in trade which followed the announcement of the extension of rationing in August. Treasury bills are rediscountable and the amount shown does not represent the whole of the commercial banks' holdings, (which are not available), but only that portion which commercial banks rediscounted for the purpose of obtaining additional funds. Although the formal record is not yet at hand, the withdrawn deposits were reported subsequently returned to the banks. Bank deposits as a whole and including the credit cooperatives, were reported in August at IL 138.8 million, as compared with IL 105.0 million, in August 1949. Of the total, demand deposits accounted for IL 119.4 million, as compared with IL 95.6 million, in August of the preceding year.

Internal controls and prices

One of the hopeful points about the situation is that the government fully appreciates the serious implications of this background. No opportunity is lost to publicize them as demanding the application of all possible control measures to maintain the purchasing power of the currency. An apparatus of regulation, an "austerity" program, has been in effect from the time the State was created, and it has been extended to the point where it may be called formidable. Exports are favored by exchange rates and raw material allocations, and in some cases they are directly subsidized. Imports are subject to license and although the licensing has some limitations in its failure to keep out luxury imports, it has considerable force, even for manufacturers who need to draw their raw material components from abroad. Prices are strictly regulated for a large list of goods and wages are tied to the cost of living. Rationing of consumption was begun in food in the spring of 1949 and, as mentioned earlier, was extended to clothing and shoes in August of this year. The "austerity" program impresses visitors as severe and compares with that England experienced at the height of the war effort.

Until the outbreak of the Korean war, these controls could be credited with a considerable degree of success in reducing the very high price level which had carried over from the years of the world war and the subsequent civil war. The cost of living had fallen from a peak of 371 percent of August 1939 in April, 1949, to 317 percent in June 1950. The value of food imports was being held down also, notwithstanding the large increase in the consuming population. Since the summer, however, it has become apparent that a part of these gains was based on the favoring tide of world events which was making supplies cheaper and markets more competitive. Although Israel participated in the round of currency devaluations in September, 1949, and reduced the official value of the Israeli pound from \$4.03 to \$2.80, the change affected exports mainly since imports and financial transactions with hard currency areas had been made at the rate of \$3.00 since establishment of the State. The disappointing result of the changing scene is the position of the cost of living index which had begun to rise again from the mid-summer low-point of 317 to 321 in September and 324 for October. The change of trend is unfavorable because the severity of the current regulation makes further measures difficult. The world wide emphasis on defense, also, not only makes supplies scarce but increases the prospect of further budgetary deficits.

On the whole, the facts of the economic and financial situation support the premise that large scale assistance continues to be imperative to the maintenance of the country. Progress in the direction of economic establishment is limited. Consumption, even though rationed, is large; production is small even though there are prospects for increase. The price level is high and exports, to be competitive, must be subsidized. In view of the uncertainties, investment from ordinary sources in a volume sufficient to fill the gap in external payments seems unlikely to be realized for a considerable period.