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July 14, 1953
Elinor Harris

Postwar International Lending in Switzerland

Switzerland's position in the international capital and credit market is based, first, on the fact that the country has escaped participation in both World Wars, and second, on the country's ability to maintain political and economic stability. Conservative fiscal and monetary policies have helped the country to keep its internal and external finances in equilibrium and to strengthen individual and corporate savings. High levels of postwar employment and income have enhanced the supply of loanable funds, while the lack of reconstruction or large-scale reconversion needs has somewhat restricted domestic demand for those funds.

In 1952, Swiss capital exports reached a record of 246 million francs ($57 million), and present economic conditions probably would permit an even higher rate. However, the strict loan standards of both government and banking community in Switzerland are likely to limit severely further expansion of international lending activities as long as present conditions of political and economic tension persist in large parts of the world.

Prewar and interwar lending

When the First World War started in 1914, Switzerland already had a strong position in the international capital and credit market, based on the international reputation of its banking and insurance institutions. During and after the war, flight capital from virtually all parts of Continental Europe poured into the country and, together with domestic capital, was reinvested abroad. During the 'twenties there was a heavy outflow of capital from the country, while there was an equally heavy inflow during years of political and economic panic, such as the depression period 1931-32 and the years of Nazi terror and war preparation, 1936-38. Thus, in the fifteen-year period from 1924 through 1938, the net inflow and outflow of capital was approximately in balance. At the eve of the Second World War, total Swiss long-term investments abroad were variously estimated at between 8 and 10 billion francs ($2 - 2.5 billion; see Appendix, Tables 1 and 2).

During the interwar period, the Swiss authorities took steps to prevent the inflow and outflow of large funds from upsetting the domestic economy. At first, flotations of foreign bonds were controlled by voluntary agreements between the National Bank and the commercial banks, which, according to continental European custom, also acted as investment bankers. In 1934 and 1938, these agreements were put on a statutory basis: the National Bank was given formal veto power over foreign credits exceeding 10 million francs and over listings of foreign securities on the Swiss stock exchanges.

Postwar lending

In the postwar period, foreign lending was resumed at a rather moderate pace, despite the liquidity of the Swiss economy and the credit needs of many foreign countries. Swiss investors remembered losses from interwar loans, and were apprehensive of social and political instability, tendencies toward nationalization, confiscatory taxation, currency depreciation, and foreign exchange controls in many potential debtor countries. Moreover, the monetary authorities were preoccupied with the threat of domestic inflation and over-full employment, which had taken the place of the dangers of deflation and mass unemployment in the interwar period; they did not favor an excessive stimulation of exports by means of easy credits since it would add to the inflationary pressure at home. This attitude was particularly noticeable in periods of booms, e.g., during the first postwar years and the period immediately following the Korean war.

Clearing and export credits - Between 1945 and 1949, Switzerland granted clearing and export credits in a total amount of almost 1 billion francs (see Appendix, Table 3); the largest credits of this kind were extended to France and Italy in 1945 and Great Britain in 1946. When Switzerland joined the European Payments Union in the fall of 1950, most of these credits were replaced by the Swiss EPU credit quota of $250 million. Only about one-third of the original clearing and export credits were actually used; however, the original Swiss EPU credit quota was virtually exhausted by the middle of 1953 and Switzerland agreed to a "rallonge" (temporary increase in the quota) of $125 million.

Although the Swiss currency is freely convertible into gold or dollars for Swiss residents and Switzerland also has liberal import policies, the monetary authorities retain strict controls over trade and payments transactions with countries having inconvertible currencies. In relations with most Central and Eastern European countries, all payments must go through central bank accounts ("centralized clearings"); in relation with most Western European countries and with some important non-European trading partners (e.g., Argentina, Egypt, and Iran), commercial banks are permitted to accept and make payments within the framework of the clearing arrangements ("decentralized clearings").

In 1952, more than 70 per cent of the foreign trade of Switzerland was conducted through clearing arrangements (including the clearing of the European Payments Union). The balance of credit and debit payments — which also includes capital transactions -- reached 243 million francs, most of which was covered by the extension of credits to foreign nations (see Appendix, Table 4).

BIS credits - The rediscount portfolio of the Bank for International Settlements, which includes mainly Treasury bills of foreign governments, rose

133 million francs between March 1945 and March 1953; about half of the increase took place in the latest twelve-month period. However, this increase is much smaller than the rise in the bank's gold holdings, which increased by about 600 million francs in the postwar period.

Other bank credits - In view of the strict preservation of banking secrecy in Switzerland, it is impossible to estimate the total volume of foreign credit granted by commercial banks. Identifiable credits granted between 1949 and 1953 totaled about 1 billion francs, of which 318 million were guaranteed by the Swiss Government. Almost one-half of the total amount went to the French Government and French nationalized industries (see Appendix, Table 5). Many of these credits apparently supplemented the automatic credit system of the European Payments Union; the others were granted to non-members of the EPU and some of them apparently took the place of previous government export credits.

Foreign bond issues - Between 1946 and April 1953, foreign bonds issued in the Swiss market exceeded 650 million francs; all but 150 million has been issued since 1950. In comparison, about 2.7 billion francs of domestic public and private bonds were issued during the postwar period (see Appendix, Table 6). More than half of all postwar foreign bonds were issued by the governments of Belgium and the Belgian Congo.

Factors affecting lending in 1952

Despite the continuing hesitation of Swiss investors to grant credits to any but the safest foreign governments or institutions, foreign lending in 1952 was substantially in excess of the level prevailing in previous postwar years. This development may be explained by changes in the Swiss balance of payments position, which stimulated foreign demand for Swiss funds, and by the increasing liquidity in the Swiss credit and capital market, which enhanced the supply of loanable funds seeking investment outlets.

The Swiss balance of payments - Despite the great importance of international transactions for the Swiss economy, no official balance of payments figures have been published. Available official data are confined to merchandise trade, changes in gold holdings and dollar balances (including holdings of dollar securities), foreign credits within the mechanism of clearing and payments agreements, and foreign bond issues. Private estimates of current service accounts and other items in the Swiss balance of payments were recently published in the press (W. Meyer, National Zeitung, Basel, May 15, 1953).

These fragmentary data, however, permit some conclusions (see Appendix, Table 7). Switzerland almost invariably has an excess of merchandise imports.

In 1952, this excess was substantially smaller than the usual surplus on current service account and there was a net surplus on total current account of about 700 million francs, as compared with a net deficit of about 120 million in 1951. The surplus was covered by a net increase in foreign private investments of about 395 million, government credits (through EPU and payments agreements) of about 220 million, and a net increase in official reserves by about 90 million.

Gross foreign investments totaled about 770 million, about equally divided in foreign bond issues, net increases in private dollar holdings, and net purchases of U. S. securities. However, almost one-half of the total apparently reflected the investment of foreign capital flowing (or fleeing) into Switzerland. The net increase in official reserves resulted from a rise in dollar holdings overbalancing a decline in gold holdings. By far the greater part of the Swiss surplus on current account was thus used to increase private and public holdings of short-term dollar assets; only about one-third of the surplus was balanced by foreign bond issues.

Domestic activity and the increase in liquidity - Switzerland is the only continental European country in which domestic savings have been large enough not only to satisfy all domestic capital requirements at existing interest rates but also to leave funds available for capital exports.

In 1952, economic activity was at a high but stable level (see Appendix, Table 8). Unemployment was virtually non-existent. The supply of money was rising in proportion to the increase in activity, but prices were stable or slightly falling. Net savings were estimated at 3 billion francs, equal to about 15 per cent of the national income (see Appendix, Table 9); the per capita amount (about 750 francs, equal to about $175) was virtually identical with the figure for the United States.

Despite the high level of activity and the slight rise in short-term credit, the demand for long-term funds as expressed in bond flotations was smaller in 1952 than in 1951. As a result, long-term interest rates tended to fall slightly: by the end of the year, the yield on government bonds averaged 2.80 per cent, as compared to 2.99 per cent in December 1951.

Monetary policy contributed to the easy money market by keeping the discount rate constant at 1.5 per cent (unchanged since November 1936) and relaxing the mild restraint on construction credits, embodied in a "gentlemen's agreement" concluded during the peak of the inflationary pressure in 1951. Competition for the limited supply of high-grade domestic securities by the growing Old Age and Survivors' Insurance Fund, too, has tended to put downward pressure on long-term domestic yields. As a result, interest rates in Switzerland were not only far lower than in most of the potential debtor countries — thus making Swiss credits particularly attractive to foreigners — but even somewhat lower than in the United States — thus making capital movements to the United States and especially investment in U. S. securities quite profitable.

Fiscal policy also increased monetary liquidity since rising military expenditures led to a deficit of about 200 million francs, in the place of a more or less substantial surplus in every previous postwar year. The deficit resulted from a popular referendum rejecting a tax increase voted by the legislature.

Lending prospects for 1953

Foreign demand for Swiss loans probably will continue to rise in the immediate future, especially in the view of the increasing difficulties foreign borrowers experience in the U. S. public and private credit market. The possibilities to satisfy that demand will depend upon the competing domestic demand for credit and the available supply of loanable funds.

Prospective credit demand - In 1953, there are some signs of the post-Korean rise in Swiss economic activity coming to an end. Prices continue to decline slowly and unemployment -- although still very low -- is somewhat higher than it had been in previous years. During the first five months of the year, exports were 6 per cent higher, but imports 15 per cent lower than in the corresponding period of 1952. These data tend to show that business favors a cautious attitude although the country is still enjoying high prosperity. The domestic demand for business credit is therefore likely to be somewhat smaller than in previous years, and domestic bond issues for the first four months of the year were actually below the amount issued in the same period of 1952. The demand for government credit also is likely to be smaller than in 1952 since the deficit for 1952 has been estimated at only half the figure for the previous year.

On the other hand, the unusual export surplus realized in the first five months of the year are likely to increase foreign demand for credit accommodation. In view of the elimination of inflationary pressure, there is no reason for the monetary authorities to frown upon an expansion of export credits at the present time. In particular, the authorities probably would prefer the extension of private credits with definite repayment obligations to those European countries that are debtors in the EPU clearing as a substitute for the granting of public extra-quota EPU credits with rather vague repayment chances.

Prospective credit supply - The continuous high level of the national income, together with the maintenance of financial stability, permits the expectation of a continuing high level of individual and corporate savings. At the same time, the low yield of Swiss bonds will continue to make foreign investments interesting to Swiss investors. Rising interest rates in the United States will probably increase the attractiveness of dollar investments; however, this tendency may well be overbalanced by the rising European apprehension as to possible future economic developments in the United States. In particular, a decline in international tensions would probably induce Swiss investors to pay more attention to investment opportunities in continental Europe; and progress in restoring the convertibility of sterling would probably divert some Swiss investments to the United Kingdom and the outer sterling area.

Conclusion

Continued expansion of Swiss international lending activities would seem to be in the interest not only of Switzerland itself and of its prospective debtors, but also of the U. S. economy. Better access to the Swiss capital market would somewhat reduce the pressure on soft-currency nations to seek grants and loans from the U. S. Government.

However, while it appears reasonable to expect a slight increase in Swiss lending in 1953, it should be remembered that the effects of such an increase must remain small. The total lending capacity of the Swiss economy, although large on a per-capita basis, is almost negligible in comparison with that of the U. S. or even the U. K. economy. Doubling the 1952 rate of capital outflow from Switzerland would hardly raise the amount over and above $100 million.

Moreover, Swiss private investors as well as the Swiss financial institutions will certainly exert all possible caution to avoid a repetition of the losses which they suffered in the interwar period through foreign lending, even in the case of such seemingly safe securities as the Dawes and Young loans. The list of those foreign governments and agencies that have been able to issue loans in Switzerland since the end of the war, shows that only a small fraction of all potential applicants could hope to gain access to that market. In the foreseeable future, Switzerland will no doubt continue to restrict the list of debtors among which it would be prepared to distribute the amount available for its foreign lending.

APPENDIX

Table 1

Selected Swiss Balance of Payments Items, 1924-1938
(In millions of U. S. dollars)

	1924	1925	1926	1927	1928	1929	1930
Goods and services	+ 13	+ 47	+ 54	+ 92	+ 94	+ 99	+ 59
Gold 1/	+ 19	+ 1	—	—	—	- 13	- 23
Capital 2/	- 32	- 48	- 54	- 92	- 94	- 86	- 36

	1931	1932	1933	1934	1935	1936	1937	1938
Goods and services	- 9	- 45	- 27	- 1	+ 1	+ 41	- 8	+ 24
Gold 1/	-361	- 49	+ 46	+ 95	+224	-261	+ 41	-144
Capital 2/	+370	+ 94	- 19	- 94	-225	+220	- 33	+120

1/ Financial imports (-) and exports (+) of gold and movement of gold held abroad by the Swiss National Bank; imports of gold for industrial purposes are included with goods and services.

2/ Balance including errors and omissions. Net capital outflow (-); net capital inflow (+).

Source: — United Nations, International Capital Movements during the Inter-War Period (Lake Success, New York, October 1949).

APPENDIX

Table 2

Net Swiss Investments Abroad, 1938

(In millions of dollars)

Swiss Long-Term Investments Abroad

Country	Amount
Germany	467
France	96
Austria	69
Czechoslovakia	31
Other Europe	117
Total Europe	780
United States	763
Mexico	4
Argentina	42
Chile	14
Other Western Hemisphere	2
Total Western Hemisphere	825
Rest of World	5
Total identified 1/	1,610

Swiss Long-Term Obligations Abroad

Country	Amount
France	16
Netherlands	124
Norway	4
Total Europe	144
United States	24
Total identified	168

1/ Includes corporate and government securities as well as direct investments.

Source: — Cleona Lewis, Debtor and Creditor Countries: 1938, 1944 (Brookings Institution, Washington, D. C., 1945).

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APPENDIX

Table 3

Swiss Clearing Credits and Export Overdrafts

Country	Date of Agreement	Duration of Agreement	Nature of credit	Amount (Millions of Swiss francs)
Belgium	1945	Fully repaid by 1950	Export overdraft	40
Czechoslovakia	December 1949	5 years to Dec. 1954	Clearing credit	10
France	November 1945	3 years extended to May 1950	Monetary credit	300
Great Britain	March 1946	3 years extended to March 1950	Monetary credit	184
Hungary	June 1950	5 years to June 1955	Clearing credit	5
Italy	1945	n.a.	Clearing credit	322
Netherlands	October 1945	3 years extended to October 1950	Monetary credit	42
Norway	July 1947	2 years extended to June 1951	Monetary credit	10
Poland	June 1949	5 years to June 1954	Clearing credit	8
Spain	May 1949	n.a.	Clearing credit	10
Western Germany	August 1949	1 year to August 1950	Monetary credit	34
Sweden	April 1948	2 years to April 1950	Monetary credit	30
			TOTAL	995

n.a. - Not available.

APPENDIX

Table 4

Swiss Payments through Clearing Agreements, 1952
(In millions of Swiss francs)

Country	Deposits of Swiss debtors in Swiss Office of Compensation	Payments to Swiss creditors from Office of Compensation	Method of Settlement of Balance: Settlement through gold or dollar transfers or through EPU 1/	Method of Settlement of Balance: EPU credits (+) debits (-)	Method of Settlement of Balance: Gold or dollar transfers	Net change in Swiss credit (+) or debit (-) position under clearing accounts
West Germany	1,073.9	635.1	(-) 502.3	(-)479.0	(-)23.3	(+) 63.5
Great Britain and Sterling Zone	713.1	1,080.2	(+) 369.2	(+)339.2	(+)30.0	(-) 2.1
France	798.6	661.4	(-) 113.1	(-)114.4	(+) 1.3	(-) 24.1
Italy	454.5	502.3	(+) 26.5	(+) 34.3	(-) 7.8	(+) 21.3
Belgium	319.5	466.7	(+) 182.3	(+)204.7	(-)22.4	(-) 35.1
Netherlands and Indonesia	245.8	261.1	(+) 1.5	(+) 0.7	(+) 0.8	(+) 13.8
Sweden, Norway, and Denmark	223.2	353.1	(+) 126.7	(+)128.0	(-) 1.3	(+) 3.2
Other decentralized clearing 2/	128.4	163.5	(-) 24.3	———	(-)24.3	(+) 59.4
Decentralized clearing	3,957.1	4,123.5	(+) 66.5	(+)113.5	(-)47.0	(+) 99.9
Centralized clearing 3/	417.6	494.7	(+) 49.7	(+) 63.8	(-)14.1	(+) 27.5
TOTAL	4,374.7	4,618.3	(+) 116.2	(+)177.3	(-)61.1	(+)127.4

1/ Receipt of gold or foreign currencies, or extension of EPU or "swing" credits (+); payment of gold or foreign currencies or receipt of EPU or "swing" credits (-).

2/ Includes Egypt, Argentina, East Germany and Iran.

3/ Includes Austria, Bulgaria, Spain, Finland, Greece, Hungary, Poland, Portugal, Rumania, Czechoslovakia, Turkey, and Yugoslavia.

Source: — Office Suisse de Compensation, 1952 Annual Report, and monthly reports of Bank for International Settlements, acting as agent for European Payments Union.

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APPENDIX

Table 5

Swiss Bank Credits

I. Credits Guaranteed by the Confederation

Recipient	Date of Credit	Extent of Credit	Purpose of Credit	Duration	Amount (Millions of Swiss francs)
Argentina	July 1950	100 per cent guarantee of Confederation	30 million Swiss francs for "unconditional" use; remainder for general financial transfers and to finance Swiss exports to Argentina	June 1951	140
Czechoslovakia	December 1949	100 per cent guarantee of Confederation; loan backed to extent of 50 per cent by Czech gold deposits	Presumably to finance Swiss exports	December 1954	30
Charbonnages de France	June 1953	80 per cent guarantee of Confederation	Expansion and modernization of equipment; interest and redemption payments to be made through coal deliveries	June 1959	60
Hungary	June 1950	100 per cent guarantee of Confederation	Finance Swiss exports in conjunction with trade and payments agreement	n.a.	10
Israel	March 1951	72 per cent guarantee of Confederation	Purchase of Swiss machinery	Loan repayable in 4-1/2 years; no interest charged	25
Poland	June 1949	Entirely guaranteed	Purchase of long-term industrial installations	June 1954	13
Yugoslavia	March 1949	75 per cent guarantee of Confederation	n.a.	September 1953	40
				TOTAL	318

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APPENDIX

Table 5 (continued)

II. Other Swiss Bank Credits

Recipient	Date of Credit	Swiss Bank	Purpose of Loan	Special Features of Loan	Duration and Interest	Amount (Millions of Swiss francs)
Anglo-American Corporation of South Africa	May 1950	Union de Banques Suisses	Unsecured registered bonds issued privately to Union de Banques Suisses; later offered to public at 98-1/2 per cent		1962, 4%	50
Austria	February 1953	Union de Banques Suisses; Credit Suisse; Societe de Banque Suisse	Modernization of Austrian telephone system	Guaranteed by Austrian Government	6-year, 4-1/2%	36
Belgium Government	October 1950	n.a.		Loan to be consolidated early 1951, by flotation of long-term Swiss loan to Belgian Government	Early 1951; Medium-term Treasury Certificates	55
Charbonnages de France	1948	Credit Suisse and Societe de Banque Suisse		1948 loan made in U.S. dollars ($10 million). Repayable through French coal deliveries to Switzerland	5 years	43
	April 1950	Credit Suisse	Finance purchase of equipment by a French power station to supply French coal mines with electric machinery	Repayment through deliveries of electric current	n.a.	7
Electricite de France	February 1950	Union de Banques Suisses; Credit Suisse; Societe de Banque Suisse	Finance French purchases of Swiss machinery to expand power plant at Nantes	Repayment through delivery of electric energy to Switzerland	n.a.	12
France	December 1952	Union de Banques Suisses; Credit Suisse; Societe de Banque Suisse	Finance Swiss machinery exports to France; reduce the French deficit and the Swiss surplus EPU position	The extension of the credit, and also its redemption, to be effected entirely through the European Payments Union	Acceptance of French Treasury Bills to be redeemed in 3 instalments by the end of 4 years	100

APPENDIX

Table 5 (continued)

II. Other Swiss Bank Credits (con't.)

Recipient	Date of Credit	Swiss Bank	Purpose of Loan	Special Features of Loan	Duration and Interest	Amount (Millions of Swiss francs)
French National Railways	December 1949	Societe de Banque Suisse and Credit Suisse	Modernization of railway equipment	Swiss francs sold by French National Railways to French Stabilization Fund and Bank of France	5-years. Basic interest rate, 1-1/8%	250
Indonesia	January 1950	Societe de Banque Suisse	Facilitate export of Swiss machinery		n.a.	50
Israel	March 1950	Credit Suisse	Purchase telephone equipment from Swiss firm		n.a.	10
South Africa	Early 1950	Societe de Banque Suisse; Credit Suisse; and Union de Banques Suisses	To finance South African purchases in Switzerland of 18 million each in 1950 and 1951	Repayable in gold; replaced in December 1952 by another credit of 30 million Swiss francs	2-3 years, at option of South African Government	36
					Known Total	649

n.a. - Not available.

Source: -- Annual Reports of Credit Suisse, Societe de Banque Suisse, and Union de Banques Suisses; B.I.S. Press Reviews; the Economist; the Statist; Neue Zurcher Zeitung; New York Times; and miscellaneous Swiss sources.

APPENDIX

Table 6

A. New Long-Term Bond Issues Offered in the Swiss Capital Markets
(In millions of Swiss francs)

Year	Foreign	Swiss domestic, private and public
1938	64.8	171.6
1946	----	526.8
1947	54.0	276.0
1948	49.5	471.6
1949	53.0	342.1
1950	208.4	173.9
1951	50.0	434.1
1952	246.4	333.1
1953 Jan.-April	0.0 1/	152.2

1/ An issue of 50 million Swiss francs, 3-1/2 per cent 15-year bonds of the International Bank for Reconstruction and Development, due July 1, 1968, was offered publicly in Switzerland on June 10.

B. Individual Issues Offered in 1952 and 1953

Issuing Authority	Nominal interest rate (per cent)	Maturity	Amount (millions of Swiss francs)
Congo Belge (guaranteed by Belgian Government)	4.00	1964-75	60.0
Union of South Africa Government	4.00	1970	60.0
Orange Free State Investment Trust, Ltd., Johannesburg	4.50	1966	25.0
Energia Hydroelectrica Andine, S. A., Lima	6.80	1952-71	2.2
International Bank for Reconstruction and Development	3.50	1962	50.0
Belgian Government	4.00	1964	50.0
International Bank for Reconstruction and Development	3.50	1968	50.0

Source: -- Banque Nationale Suisse Bulletin Mensuel (January and May, 1953); and Third Annual OEEC Submission of Switzerland (April, 1951).

APPENDIX

Table 7

The Swiss Balance of Payments, 1952 and 1951
(In millions of Swiss francs)

	1952	1951
A. Current Account	+705	-121
1. Exports	+4,748	+4,690
2. Imports, c.i.f.	-5,193	-5,911
Trade balance	-445	-1,221
3. Tourist traffic (net)	+550	+500
4. Capital income (net)	+300	+300
5. Other services (net)	+300	+300
Balance of service items	+1,150	+1,100
B. Capital Account 1/	-395	+67
6. Long-term foreign bond offerings	-246	-50
7. Net purchase of securities in U. S.	-255	-258
Long-term U. S. securities	(-218)	(-197)
Long-term foreign securities	(-37)	(-61)
8. Change in Swiss private dollar assets	-266	+118
9. Other capital transactions 2/	+372	+257
C. Official Financing 1/	-310	+54
10. Short-term credits	-223	-53
Through EPU	(-96)	(-420)
Through payments agreements	(-127)	(+367)
11. Exchange position of National Bank	-263	+29
12. Official gold reserves	+176	+78
Through EPU (- equals receipt)	(-95)	(-256)
Other (+ equals sale)	(+271)	(+334)

1/ An outflow of Swiss capital or a rise in Swiss gold or foreign exchange holdings is represented as minus (-); while an inflow of capital or a decline in gold or foreign exchange holdings is represented as plus (+).

2/ Residual, including all transactions that are not capable of statistical determination. This item is positive for Switzerland because significant amounts of flight and speculative funds usually flow into the country.

Source: -- Trade data: International Monetary Fund, International Financial Statistics, (June, 1953). Service items, change in Swiss private dollar assets, and in the exchange position of the National Bank: W. Meyer, National Zeitung (No. 217, May 15, 1953). Official gold reserves and private security purchases (and sales) in U.S.: Federal Reserve Board, Federal Reserve Bulletin (June 1953). Swiss EPU credits and gold receipts: Swiss National Bank, Monthly Bulletin (May, 1953). Payments agreements credits: Office Suisse de Compensation, 19th and 20th Annual Reports.

APPENDIX

Table 8

Selected Financial Indicators in Switzerland

Year	National income 1/	Government bond yield 2/	Cost of living 3/	Wholesale prices 3/	Commercial bank loans and investments 4/ Government	Commercial bank loans and investments 4/ Non-Government	Money supply 4/	Unemployment 5/	Gold and foreign exchange reserve of National Bank 6/
1938	8.70	3.24	61	46	96	2,676	4,712	8.6	764
1939	8.83	3.76	62	48	84	2,805	4,744	6.5	630
1945	13.47	3.29	93	95	84	4,312	8,425	1.6	1,142
1946	15.03	3.10	93	92	106	4,849	9,189	1.0	1,181
1947	16.84	3.17	97	96	162	4,999	9,580	0.8	1,238
1948	17.65	3.42	100	100	160	5,328	9,818	0.6	1,400
1949	17.36	2.94	99	95	169	5,421	10,568	1.6	1,502
1950	18.16	2.67	98	94	126	5,939	11,008	1.8	1,441
1951	19.47	2.95	102	105	133	6,391	11,219	0.8	1,440
1952									
I	n. a.	2.84	105	104	146	6,656	11,183	2.4	1,425
II	n. a.	2.86	105	102	148	6,642	11,218	0.4	1,410
III	n. a.	2.85	105	101	157	6,524	11,209	0.2	1,431
IV	n. a.	2.82	105	101	165	6,655	11,396	1.0	1,472
1953									
I	n. a.	2.63	104	99	174	6,637	11,254	3.0	1,474

n. a. - Not available.

1/ Billions of Swiss francs. 1 SF = 23.3¢.

2/ Per cent: Weighted average yield to maturity of 12 bonds issued by the Confederation and the Swiss Federal Railways having maturities of at least 5 years.

3/ 1948 = 100. Average for the period.

4/ Millions of Swiss francs: End of period.

5/ Per cent of insured workers.

6/ Millions of U. S. dollars: End of period.

Source: -- International Monetary Fund, International Financial Statistics, (June, 1953).

APPENDIX

Table 9

Net Savings in Switzerland, 1952

Items	(Millions of Swiss francs)
Savings deposits and medium-term bank bonds	1,000
Old-Age and Survivors' Insurance Fund (annual increase)	485
Insurance premiums	500
Business profits retained	700
Other forms of savings	400
Total net savings	3,085

Source: — Bank for International Settlements, Twenty-Third Annual Report, Basle, June 8, 1953.

July 14, 1953

Comments on "Economic Strength for the Free World,"
A Report to the Mutual Security Agency

Stephen H. Axilrod

Another report has been added to the already large literature on the possible means of aiding the relatively underdeveloped areas in their attempts at economic development. This Report was prepared for the Mutual Security Agency by its Advisory Committee on Underdeveloped Areas and was transmitted to the Director in January of this year.1/ In publishing it now, the Director for Mutual Security noted that it "can serve as one of the guides in the review of programs for Mutual Security now under way or which may be undertaken in the future."

Highlights of the Report

The Report is divided into four sections: (1) ends and means, (2) direction of development, (3) financing of development, and (4) administration of development. The first and fourth sections contain very little of interest. The first section perhaps emphasizes more than is customary the limitations to economic development embodied in a country's customs, institutions, underlying values and attitudes and, consequently, the need for a better understanding of these elements before material assistance can be effective. In the fourth section, the question of multilateral or bilateral assistance to underdeveloped areas is discussed; after considering the strong case that can be made for channelling most United States aid through a multilateral assistance program, the Committee notes that bilateral programs must be continued for some time to come because of special United States interests and because international organizations as presently organized may be less effective.

Direction of development -- In discussing the pattern of development best suited to a country, the Committee stresses the point that leaders of underdeveloped countries should be made aware of the dangers of diverting too many resources from primary production to "fashionable schemes for industrialization." Consistent with this view, the Committee believes that a "flexible and well-financed basic materials program, not tied strictly to the narrow and changing requirements of the U. S. domestic stockpile, should be an important part of our total relationship with each underdeveloped country." Further, the Committee recommends that steps to stabilize the demand for and the prices of major primary commodities should be taken as an integral part of an economic development program; the object would be smaller fluctuations rather than rigid prices.

The Report states that only to the extent that conditions placing a premium on self-sufficiency are removed "will the various countries be given a substantial incentive to turn their efforts to forms of production in which they have comparative advantage." From the discussion, it appears that the Committee believes this comparative advantage to lie in the further

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1/ The Chairman of the Committee was Mr. John Orchard, a professor of Economic Geography at Columbia. The Committee included Edwin G. Arnold, C.W. de Kiewiet, Arthur B. Foye, John W. Harriman, Lester K. Little, Edward S. Mason, Stacy May, and Whitney H. Shepardson.

development of foodstuffs and other primary materials, as well as light industries which have a high ratio of labor to capital and which will, therefore, absorb large numbers of workers released from the land.

Since the Report deals with programs administered by the Mutual Security Agency rather than the Technical Cooperation Administration, some consideration is given the problem of military costs. The Committee concludes that extraordinary military costs (such as new roads capable of carrying heavy military vehicles), as well as the direct provision of equipment, should be part of country programs. (Although the wording is extremely vague, there are indications that the United States should also be ready to finance some of the increased demand for consumer goods resulting from military expenditures.)

Financing of development -- The Report stresses that U. S. Government aid should be kept to a minimum and that the "smallest practicable amount" should be in the form of grants. Grants are suitable for technical assistance, military purposes, and for special purposes such as an immediate need for strategic materials or instances where rapid development has some particular non-economic urgency as in the case of India. Other public aid should be in the form of loans or financing instruments which, though somewhat like straight loans, have various gimmicks attached to them such as the possibility of repayment in local currency, partial amortization, the payment of interest only if earned by the project, or repayment in basic materials.

Private investment, both domestic and foreign, should be encouraged to the greatest extent possible. The usual measures -- tax relief, insurance and guarantees against convertibility and expropriation, and the development abroad of a favorable investment climate -- are briefly noted. Protection of private enterprise through participation with the International Bank or the Export-Import Bank is considered another feasible method of encouraging private investment. New types of financing institutions to encourage private capital are also noted. Consideration is given the mobilization of private capital through "overseas investment trusts" and the stimulation of direct investment by small and medium-sized corporations through the establishment of "investment clearing houses" possibly on a regional basis. Regional financial institutions are also considered as is the proposed International Finance Corporation. Where possible, all productive investment should be left to private enterprise.

The Committee believes that there are many fields (primarily within the group of basic utilities) not attractive to private investment under present or foreseeable conditions and that public investment through loans or near-loans will have to be used for these purposes. The Report then states, "Existing arrangements for the promotion of public investments are both inadequate and inflexible."

In examining the Export-Import Bank, the Report finds, "Most of its loans are 'tied' to the purchase of equipment in the United States for dollars; it must receive repayment in dollars; and its interest rates tend to be rather high and inflexible." It is also noted that the Bank "has no machinery for promoting sound projects or for assistance to borrowing countries in devising sound over-all development programs . . ."

Although noting that the International Bank has done more to stimulate sound economic development than the Export-Import Bank, the Committee goes on to point out its limitations to financing development: it must depend on funds raised in the New York market; it cannot lend to non-member countries; it needs a government guarantee; its ability to lend dollars to individual countries is limited by the size of dollar obligations these countries have already incurred; and thus far it has been able to secure only a limited amount of non-dollar currencies.

Finding that additional public funds need to be provided and that lack of flexibility in the supply of these funds is a serious impediment, the Committee suggests the various methods of financing noted in the first paragraph, methods which might be called near-loans since they fall somewhere between outright grants and bankable loans. In addition, new institutions may be called for. The Committee concludes, "If neither the International Bank nor the Export-Import Bank adopts sufficiently flexible policies and practices, the need is indicated for a new U. S. institution."

Comments

On the whole, the Report is forthright and suggestive; there are two points, however, which bear further discussion: (1) the relationship expounded in the Report between the doctrine of comparative advantage and the possibilities of development in underdeveloped countries imposes certain obligations on this country; (2) financing public investment by novel means (though necessary to encourage rapid development) may actually discourage (or at least not encourage) private investment.

Comparative advantage and economic development -- Although it is certainly true that autarkic development is undesirable both from the point of view of the developing country and the rest of the world, the extent to which expanded basic materials production in these countries is their most desirable pattern of development is still an open question. As the Report notes, the form of development will vary with the resource endowment of the country. But it fails to point out that those countries generously endowed with basic materials can only "gain" from the increased production of those goods if they can in turn purchase from other countries commodities desired by them but which would have cost more in terms of resources used per unit output in home production than would the production of basic materials. These gains from an effective international allocation of resources may not work themselves out in a world filled with trade restrictions, tariff barriers, and inconvertible currencies since raw material countries may not be able to purchase goods in the cheapest market or world resources may not be allocated in such a way as to have goods available on the cheapest possible terms. The tendency for underdeveloped areas to want to produce goods which could better be produced elsewhere will probably remain so long as imperfections in the international exchange of commodities exist to such a large extent. The Report should have pointed out that obstacles to the achievement of materials security by the United States are contained in part in the obstacles to trade which we, in some measure, are responsible for.

The exact nature of the relationship between the doctrine of comparative advantage -- a static adjustment in the international economy to given wants, resources, and technology -- and economic development is a matter for economic theorists to work out further. One thing, however, is certainly clear: if the doctrine contains implications about the possibilities and conditions of development for an underdeveloped area, it should equally well be applied to the development of an already developed area (although it is, to say the least, difficult for the doctrine to explain why one area has a high and another a low per capita real income). In aiding an underdeveloped country, therefore, the developed country should in its program include measures to reduce tariffs and trade and exchange restrictions so that the underdeveloped country can obtain the largest possible increase in real income from expanded materials production.

<u>Relationship between public and private developmental financing</u> -- The possible means of financing development through both internal and external sources have been the subject of so many reports that there is little need to discuss the alternatives in any detail. This Report takes as a dictum the undesirability of large amounts of grant aid. Since underdeveloped areas probably cannot service a large number of dollar loans and since some public investment is necessary, the Report emphasizes the desirability of public loans with peculiar repayment provisions. In addition, the Report wishes to increase the participation of private investment in overseas development while holding public aid to a minimum. They do not appear to realize, however, that public investment through near-loans may react unfavorably on the willingness of private investors to participate in economic development.

Some little progress has been made toward making private investors aware of the potentialities and security of either direct or indirect investment in the less-developed countries; this progress has in large part been the result of careful financing by the International Bank, of the Bank's progress in impressing the countries with the need for soundly conceived development programs, and of the large number of other activities by various governmental agencies and private groups which have gradually brought the notion of overseas investment into the public consciousness. Measures which involve the Government in various forms of near-loans may make it more difficult for the International Bank or the Export-Import Bank to secure private participation in their ventures because of the possible confusion and misunderstandings created in the minds of prospective investors by the publicity given various sorts of financing instruments. The notion that International Bank or Export-Import Bank loans to underdeveloped countries are sound (hence that private loans or investments in these countries may also be desirable or sound) may be more difficult to convey if there are other loans outstanding which, by the nature of their repayment provisions, are unsound from the investor's point of view.

It would be better if grants and loans were clearly distinguishable. Some projects may require loans at somewhat lower rates than others. If neither Bank can provide funds at that rate, some consideration might be given the use of appropriated funds for those purposes. But there is an important difference in degree between loans at somewhat lower rates with a definite repayment schedule and long-term low interest loans with either a tacit agreement that there will be no repayment or a repayment scheme based on various contingencies. If the underdeveloped country cannot afford to pay interest (or much interest) on a particular investment project, it is conjectural whether it should be undertaken. If it should be undertaken, then a grant is desirable. If, for a variety of reasons, grant-aid is not feasible, then a near-loan may be unavoidable. But it should not be thought of, in itself, as a good thing.

The Report concludes that United States participation in the development of underdeveloped areas should be given a sense of permanence and continuity. If this sense of permanence is to assure the underdeveloped areas, however, it must be selfless; near-loans as a substitute for grants, would give the impression, from the borrowing country's point of view, that this country is primarily interested in maintaining continuous contact with and perhaps some measure of control over their economy. A more impressive sense of permanence would be given the underdeveloped countries if we stood ready to contribute a substantial share to an effective multilateral assistance program.