L.5.2 RFD 232

Board of Governors of the Federal Reserve System

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

February 9, 1954



NOT FOR PUBLICATION

Monetary Policy in a Planned Economy — The Swedish Experience, 1950-1953

February 9, 1954
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Economic policy in Sweden has been formulated since 1932 by the Social Democratic Party. This party, like other socialist parties in western Europe, favors increased participation of the State in economic affairs in order to maintain full employment and to attain an equitable distribution of income. Unlike the Labor Party in the United Kingdom, however, the Swedish Social Democrats have never embraced a policy of nationalization; instead, they have sought to control Swedish economic development by financial measures supplemented by selective direct controls. Swedish monetary policy has been largely subordinated to this aim.

Monetary policy has been the subject of nearly continuous debate in Sweden since the end of World War II. In the early postwar period, inflationary pressures in the Swedish economy were principally controlled by fiscal measures, exchange rate adjustments, and direct controls over prices, wages, and credit. In general, traditional measures of monetary policy were neglected. During those years, the relative merits of quantitative versus qualitative monetary controls were judged almost exclusively on the basis of their effects on interest rates. The Swedish authorities maintained that a rise in interest rates should not be used to aid in the control of inflation. They reasoned that to be effective a rise would have to be so large that it would reduce employment and production, and that any rise would increase the cost of housing construction, hence rents, and thus the cost of living. They also felt that a rise would alter the distribution of income in favor of the rentier and the higher income groups.

In response to increased inflationary pressures following the outbreak of the Korean conflict, more orthodox monetary techniques were introduced in 1950 to supplement, and in some cases to replace, fiscal measures and direct controls. In attempting to apply a more restrictive credit policy since that time, however, the Swedish monetary authorities have sought to maintain much the same interest rate pattern as existed previously. Whereas changes in the reserve requirements have limited the supply of credit, fiscal measures have not sufficiently reduced the demand for credit. As a result, a system of credit control agreements between the Riksbank and the major financial institutions, has been utilized to ration the available funds among the various credit demands so as not to permit upward pressures on the interest rate level. In allocating the credit facilities, moreover, priority has been sought for government-sponsored projects. To this end, the credit control agreements have imposed interest rate ceilings on new bond issues; these ceilings have prevented private borrowers from outbidding the public authorities by offering a substantial interest rate differential, and thus have helped to channel funds to the so-called priority projects.

Since the inception of this system, the credit agreements have been revised, renewed, or their coverage extended on several occasions, most recently in the summer of 1953. The changes have been made necessary by the repercussions of the agreements on the money and capital markets as well as by the need to meet altered economic conditions. These developments and their influence on economic progress in Sweden illustrate the dilemma of the Swedish monetary authorities -- how to promote internal and external financial stability, maintain a high level of economic activity, and give priority to government-sponsored investments by means of a monetary policy that virtually excludes increases in interest rates.

## Monetary policy, 1950-1953

After a period of relative financial stability in 1948 and early 1949, inflationary pressures reappeared in the Swedish economy following the devaluation of the krona and the outbreak of the Korean war. The effects on the domestic price level of the rise in import prices could not be cushioned by subsidies without further aggravating the budget deficit: some upward adjustment of domestic prices was therefore unavoidable. Increased wage demands were expected with the expiration of the war-imposed wage ceilings. Furthermore, the export boom in forest products, together with the rise in freight rates, brought an inflow of foreign exchange that could serve as a base for credit expansion.

To meet this situation, the Riksbank took the following actions in 1950. Commercial banks were required to keep up to 10 per cent of their total liabilities, exclusive of savings deposits and contingent liabilities, in the form of liquid assets, a fixed percentage of which had to be in cash and Riksbank deposits. The Riksbank withdrew its support of government bond prices with the result that, by the end of 1950, the effective yield of 3 per cent bonds had risen to 3.32 per cent. The Riksbank's discount rate was then raised from 2 1/2 to 3 per cent to conform with the new interest rate pattern. Finally, the Riksbank concluded an agreement with the commercial banks for the control of credit. This agreement, which proved to be the forerunner of several subsequent agreements, provided for restrictions on consumer credit and on lendings for speculative purposes: bank credit was to be granted only to aid export and import-substitute industries or for other "essential" purposes. 1/

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1/ For fuller details of the measures taken in 1950, see this Review, February 29, 1951.

At the time of their introduction, these moves were hailed as a "return to monetary policy." 1/ This reaction, however, proved to be rather premature; for, at the end of 1950, the Riksbank resumed its purchases of government securities, though at the lower prices to which they had fallen. It then announced that further alterations in the yields of government securities would not be influenced by market considerations. 2/

The February 1952 credit agreement — Notwithstanding the measures introduced in 1950, the influx of foreign exchange in 1951 permitted the continued expansion of bank credit. Bank credit rose rapidly as a result of the export boom, increased export and import prices, and speculation against price increases, which contributed to further increases in the domestic price level. Fiscal measures enacted in 1951, such as a 12 per cent tax on new investment, lower depreciation allowances, and a tax on pulp and paper exports, were not immediately effective in restraining the price increases. Consequently, a new credit control agreement was negotiated with the commercial banks in February 1952. 3/ This agreement replaced the cash reserve requirements by more stringent liquidity ratios requiring the banks to maintain a certain proportion of their liabilities in the form of either cash, Riksbank deposits, or government securities. 4/ The banks also agreed not to change the distribution of their lendings nor to raise the interest rates on mortgage loans or for government borrowings, which were then at 3.5 per cent. The Riksbank reserved the right to pass on the terms and timing of all new bond issues. This last provision had the consequence that, in practice, the Riksbank refused to allow the flotation of industrial bonds bearing more than a 3.75 per cent interest rate.

The February agreement was instrumental in halting the expansion of bank credit and the rise in prices. Its effects were enhanced by the tapering off of the export boom, the growing effectiveness of the aforementioned fiscal measures, and the adoption of a retroactive excess profits tax. Most banks reportedly were unable to meet the liquidity requirements instituted by the agreement, which had the immediate consequence of halting

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1/ Lars-Erik Thunholm, "Sweden's Steps to Check Inflation", The Banker, September 1950; "Back to Monetary Policy," Svenska Handelsbanken Index, December 1950.

2/ Riksbank Memorandum to the Banking Committee of the Riksdag, April 28, 1951.

3/ A law was passed in December 1951 for the control of interest rates but it has never been used. Its main purpose was to provide a bargaining weapon for the Riksbank in negotiating with the commercial banks.

4/ These ratios were differentiated according to the size of the bank. Neither the ratios nor the method of calculation have been published.

further extensions of bank credit. In fact, commercial bank lendings declined by kr. 346 million during the second quarter of 1952 as extraordinary tax payments due in that period increased the demand for cash, thereby placing further strain on the banks' liquidity position. 1/ The lower level of economic activity ensuing from the collapse of the export boom contributed to the further decline of bank loans by kr. 167 million in the succeeding twelve months. As a result, bank loans and advances by the middle of 1953 had returned to their mid-1951 levels. (Appendix, Table 1)

The position of the banks began to ease in the fall of 1952. An increasing government deficit improved the liquidity of the economy and led to a growth in bank deposits. In turn, the rise in deposits permitted the banks to purchase government securities and thereby improve their liquidity positions: the rise in bank deposits was matched by a virtually equal increase in the banks' holdings of Treasury bills and bonds. (Appendix, Tables 1 and 2)

The effects of the credit restrictions on various sectors of the economy are indicated by a recent survey of the distribution of bank lendings. This survey, comparing May 1953 with May 1952, noted increases only in the categories of trade and services, municipalities, credit institutions, and construction industries; the virtual doubling of advances to the municipalities is illustrative of the increasing activity of the municipalities in financing housing construction during this period. The most significant change, however, was the decline in credits to industry: reduced economic activity (to which the credit restrictions may have contributed) was undoubtedly an important factor in this development, but, when contrasted to an increase in credits to the trade and services sector, this decline seems to indicate that industry has borne the brunt of the credit restrictions. (Appendix,Table 3)

The tight conditions prevailing in the banking system during the summer of 1952 were also reflected in the capital market; a decline in prices and in turnover set in early in 1952 in both the stock and bond markets. The bond market was particularly affected by the credit restrictions, the stock market being more decisively influenced by foreign trade prospects. The fall in industrial bond prices was especially acute; government bond prices showed less change because of the high demand for government securities by the banks. Although the market eased somewhat later on, bond prices remained lower than prior to 1952. (Appendix, Table 4)

Because of the varying degrees of tightness in the capital market, new private and municipal bond issues faced an uncertain reception in 1952. In the summer of that year, the city of Stockholm was forced to give up an 85 million kronor issue at the prescribed rate of

1/ The Swedish krona is equal to about 19.3 U. S. cents.

3 1/2 per cent and to borrow instead from the commercial banks on a two-year promissory note. Since interest rates were strictly controlled, new private issues had to be made attractive to institutional investors by extending call dates, providing semi-annual instead of the usual annual interest payments, and similar concessions. On the other hand, many industries began to borrow on ten-year promissory notes at four per cent rather than seek funds in the open market. As this rate was about one-fourth per cent higher than that normally approved by the Riksbank for industrial bond issues, these notes proved especially attractive to investors. As a result of these conditions, the value of new private bond issues in 1952 fell to almost one-half the level of the preceding year. (Appendix, Table 5)

The December 1952 credit agreement -- By December 1952, the insurance companies had increased their holdings of industrial promissory notes to such an extent that "priority" issues were being neglected. The renewal of the credit agreement with the banks in that month was therefore made the occasion for including the insurance companies among the participants so as to prevent them from providing credits that were unavailable through the banking system. By this agreement, the insurance companies could thereafter increase only their holdings of government and municipal bonds, corporate debentures specifically approved by the Riksbank, mortgages on buildings constructed after June 1951, and personal loans secured by life insurance policies; increased holdings of industrial notes were to be permitted only insofar as their proportion to total assets remained unchanged. The agreement retained the maximum rates for municipal borrowings and mortgage loans at 3.5 per cent and set a maximum rate of 3.75 per cent for power plant bonds; but the maximum permissable rate for industrial bonds was increased by one-quarter per cent to four per cent. The threat of compulsory legislation governing the holdings of the insurance companies was necessary to obtain this agreement.

The financial difficulties of the municipalities at this time and their need for long-term funds arose primarily from the growth in their financing of housing construction, which was not covered by a corresponding increase in municipal revenues. Their difficulties in obtaining funds in the capital market were accentuated by the increase in interest rates on industrial bonds conceded by the Riksbank in the December 1952 agreement. The widened spread between rates on public and private issues made it more difficult for the municipalities to float new bond issues. At the end of 1952, for example, it required over a month to place long-term bonds of the cities of Stockholm and Göteborg. Göteborg attempted another bond loan in March 1953 but it moved so slowly that the Riksbank forbade all other flotations until the Göteborg loan was placed. The "imbalance" in the capital market created by the December agreement is well illustrated by the fact that, the month before, Bofors had easily placed a kr. 40 million, 23 year bond issue at four per cent, the largest industrial bond issue in Sweden in twenty years.

The 1953 credit agreement -- The agreement with the insurance companies was cancelled by the Riksbank in June 1953, principally because of the continuing difficulties of the municipalities. The immediate cause was an attempted bond flotation by the city of Stockholm. The city had reached agreement with the banks on a bond issue bearing interest at 3.6 per cent. This issue was vetoed by the Riksbank as the maximum interest rate permitted for such issues was only 3.5 per cent. The city then tried to issue 10 to 30 year promissory notes at 3.6 per cent; but because promissory notes are not considered "gilt-edged", this attempt was a failure.

After three months of negotiation and, finally, a renewed threat of compulsory legislation, a new agreement with the insurance companies, to which the banks acceded, was reached in the fall of 1953. The main purposes of this agreement were to assure the financing of projects held desirable by the Government and to relieve the financial difficulties of the municipalities. The agreement provided that new construction be financed through the banks rather than, as previously, by the municipalities and that, upon completion of construction, the mortgages be taken over by the insurance companies; such bank financing, however, was not to exempt the banks from meeting their liquidity requirements. In addition, the agreement lowered the maximum long-term interest rates for new bond issues from 4 to 3 3/4 per cent for industrial bonds and from 3 3/4 to 3.6 per cent for power plant issues. Rates for mortgages and for public borrowings were held at 3 1/2 per cent.

By narrowing the spread between interest rates on private and public bond flotations, and thus making industrial issues relatively less attractive, it was intended to make it easier for the municipalities and for the Central Government to obtain funds. The removal of the municipalities from financing housing construction, moreover, curtailed their demands on the capital market. These developments were particularly important for the Government because the budget deficit for 1953/54 was estimated at kr. 1,828 million and a continued high level of government expenditures was expected for the next few years.1/ For these reasons, it was believed that continued recourse by the Government to the capital market would be necessary. (Appendix, Table 6)

The improvement in the liquidity positions of the banks, which had begun in the fall of 1952, continued throughout 1953 as a result of continued deficit financing and, in the last half of the year, an inflow of foreign exchange. However, the incentive for depositors to transfer funds from the banks into the capital market was reduced by the terms of the 1953 credit agreement wherein long-term interest rates were lowered

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1/ The Nothin report on automatic changes in government expenditures estimated an increase in ordinary state expenditures of about kr. 1,300 million by 1958/59.

while short-term rates remained unchanged. The accumulation of deposits in the banks therefore accelerated slightly after the 1953 agreement went into effect. Shortly thereafter, the banking system as a whole was able, for the first time, to meet the liquidity requirements imposed in February 1952; but, as a consequence of this development, the scarcity of funds in the capital market became even more marked.

To correct this situation, the Riksbank lowered its discount rate from 3 to 2 3/4 per cent on November 20, 1953. 1/ This move sought to encourage the flow of funds into the long-term market by establishing a wider margin between short-and long-term interest rates. Also, the increasing liquidity of the banks permitted a lower rate on Treasury bills.

The consequences of the 1953 agreement and the lower discount rate were immediately apparent. The financial community which, earlier in the year, had been convinced that long-term interest rates were bound to rise now revised its opinion to the extent that the long-term trend was believed to be downward. This switch in opinion had the effect that bonds issued with long conversion dates and any interest rate higher than 3.5 per cent began to find quick acceptance. Even the Stockholm notes at 3.6 per cent were finally placed.

## The effectiveness of Swedish monetary techniques

Reserve requirements -- The adoption of more stringent reserve requirements in February 1952 halted the rise in bank credit to private borrowers but, at the same time, the new requirements favored an expansion of bank investments in government securities. Since banks normally prefer interest-bearing assets to idle cash balances, the permission to count government securities as bank reserves meant that most reserves would be held in that form. This provision had the effect of assuring the easy financing of any government deficit. For instance, as long as banks failed to meet their reserve requirements, any new deposits would have to be used to improve their reserve positions by the purchase of g government securities. Such purchases, however, would create new deposits: if the Government sells securities directly to the commercial banks and deposits the receipts with them, both bank deposits and bank reserves are increased. The same result would be obtained even if government funds were deposited in the central bank: these funds, in financing an excess of government expenditures over revenues, would flow to the private sector and thus serve to expand private bank deposits; these new deposits would then be used to purchase government securities.

1/ In June 1952, the Riksbank adopted a floating rediscount rate on bills of exchange; because there has been no rediscounting since that time, the move has had little practical significance.

In an inflationary situation, these reserve requirements would fail to curb the extension of bank credit. If the banks had satisfied their reserve requirements, for instance, government deficits financed through the banks would serve as a base for the expansion of commercial lendings, thus compounding the inflationary danger. Even with a government surplus and a consequent shortage of new government securities, the banks could purchase — to some extent at least — the securities from non-bank investors and thus provide reserves for the further expansion of bank credit. This last possibility has been somewhat restricted inasmuch as the insurance companies have agreed not to change the distribution of their assets and could not, therefore, sell large blocs of government securities to the banks.

By their nature the Swedish reserve requirements remove a great deal of control over monetary developments from the hands of the monetary authorities. Open market operations, for example, serve little purpose in this system: the purchase or sale of government securities by the commercial banks would only substitute one type of reserve asset for another; such operations would not expand or contract the bank reserves upon which credit is based. Instead, the ability to expand or contract the credit base is made primarily dependent upon the debt operations of the Government. Presumably the central bank could alter the reserve ratios; but this procedure is much less flexible than open market operations and less adaptable to meeting day-to-day changes in banking conditions.

Interest rate ceilings — The interest rate ceilings on new bond issues which have been established by the credit control agreements have, for the most part, been below the rates that would have prevailed in a freer market. As a result, the Riksbank has had to maintain strict control over new issues in order to limit the strains on the capital market. The existence of ceilings in these circumstances has been conducive to the development of a "grey" capital market — that is, the placement of investable funds outside of the normal channels of the banks and insurance companies, and therefore, not subject to Riksbank control. The availability of such funds is indicated by the increased willingness of non-institutional investors to participate in capital market offerings in 1953 and by the recent growth in the liquid resources of individuals and corporations. The degree to which industry would be tempted to tap these funds depends largely on the optimism prevailing concerning business expectations. Should the business outlook improve from its present level, the likelihood of such private placement would increase proportionately.

Credit control agreements — The system of credit control agreements has achieved its objectives of restricting bank credit, assisting the financing of "priority" projects, and maintaining a low interest rate level. But in order to correct the leakages continually appearing in the system, periodic revisions of the credit agreements have been necessary; moreover, the system has had to be expanded to include additional financial institutions.

These revisions have hampered the normal functioning of the money and capital markets: the negotiation of the December 1952 agreement with the insurance companies, for instance, created such uncertainty in the bond market as to halt for some time virtually all activity. The prospect of further continuous revisions might, in itself, be an unsettling influence in the money and capital markets, and thus lessen the chance o of continued effective operation of the system.

A more basic criticism of this method of credit control is its inflexibility. Credit policy governed by agreements extending over relatively long periods allows the monetary authorities little leeway in adjusting that policy to short-run changes in economic conditions. In addition, the protracted negotiations by which the agreements are revised entail further delays in necessary alterations of policy. Finally, negotiation usually implies compromise, and thus detracts a measure of authority and control from monetary management; it might result in a policy not entirely suited to existing circumstances.

## Swedish monetary policy and economic development

A salient feature of recent economic developments in Sweden has been the successful attempt of the State to appropriate a larger share of the economy's real and financial resources. Whereas gross national product at constant prices increased from 1949 to 1952 by 7 per cent, government purchases of goods and services (excluding investment) rose by 16 per cent. In the same period, total fixed capital formation rose by 14 per cent, but government expenditures for fixed investment increased by 25 per cent. (Appendix, Table 7)

The increase in the government share in GNP, and particularly in investment, has been deliberately planned. A long-range economic program drawn up for the years 1951-1955 provided for the concentration of investments in trade, transportation, communications, health, and housing. With the exception of trade, all these categories are in the government sector. The emphasis on these investments grew out of the belief that, prior to 1951, investment in industry and agriculture had been disproportionate to the development of a well-balanced economy.

The task of Swedish financial policy has therefore been to curb investment demands from industry and agriculture, and to channel available savings into desired-investment outlets, i.e. mainly to the Government. The investment tax and the reduction in depreciation allowances contributed to the restraint of private investment demands, while the reserve requirements and the interest rate ceilings have promoted the diversion of savings to government use.

The success of this policy is further demonstrated by the constant decrease since 1950 in private fixed capital formation (measured at constant prices). The Swedish Institute for Economic Research forecast a continuation of this trend in 1953: while government fixed investment was estimated to increase by kr. 530 million (1952 prices), private fixed investment was expected to decline by kr. 30 million; the largest increases were expected in dwellings, communications, and the military establishment, while the manufacturing and mining sector would suffer the major drop. 1/

Although total investment expenditures have been maintained at a high level, the growth of gross national product has slackened in recent years coincident with the decline in private investment. Preliminary estimates of Swedish GNP at constant prices indicate an increase of less than one per cent per annum in 1951 and 1952. It is difficult, however, to establish a simple causal relationship between the decline in private investment and the slower growth of gross national product. For instance, an increase in the statutory annual vacation period from two to three weeks in 1952 contributed to reduced production. Moreover, variations in exports — largely reflecting changes in world demand, are of great importance to the Swedish national income, merchandise exports alone representing about 20 per cent of GNP.

Another factor retarding recent economic progress in Sweden was the long duration of the price adjustment imposed by the Korean boom. The upward adjustment necessitated by that event was complicated by the abandonment of price controls and subsidies, which, in the early postwar period, had isolated the Swedish price structure from world price developments. Consequently, prices advanced more rapidly in Sweden from 1950 to 1952 than in most of western Europe. The fiscal and monetary policies pursued in 1950 and 1951 may be criticized for not sufficiently restraining these price increases but, in view of the fact that Swedish prices showed relatively little change in the early postwar years, a considerable upward price adjustment was probably unavoidable in any case.

In 1952, the rise in the Swedish price level was particularly out of phase with developments in the rest of western Europe. Wholesale prices rose 6 per cent and money wages increased 17 per cent at a time when prices and wages were generally stable in other European countries. The ensuing increase in the Swedish cost level took place at a time when world demand was declining and other producers were becoming more competitive. In these circumstances, the declining level of private investment probably prevented Swedish industry from offsetting these higher costs through increased productivity and production. To the extent that Swedish monetary policy contributed to the failure or inability to reduce costs of production, it must bear some responsibility for recent export difficulties of Swedish industry and thereby for the rise in unemployment and the stagnation of industrial production during the first half of 1953.

1/ Konjuncturinstitutet, Konjuncturlaget Hösten 1952.

## Conclusion

The projected government deficits, the continued high demand for housing, and the promised abolition of the investment tax in 1954 probably make the continuation of restrictions on credit to the private sector necessary. As long as interest rates adjustments are narrowly circumscribed, the present system of credit control agreements is perhaps the most effective available method of implementing such a policy. However, the inflationary danger presented by the government deficit in conjunction with the peculiar reserve requirements of the Swedish banks (together with the already substantial growth in the liquidity of individuals and business) will probably make it necessary for these controls to be made ever more restrictive and their scope to be ever extended. The latest credit control agreement would thus prove to be but a temporary expedient: like its predecessors, it would again and again require adjustment to be made effective. The prospect of repeated changes in the basis of credit activity, and of prolonged periods of negotiations preceding each change, might well increase uncertainty and create serious dislocations in the Swedish money and capital markets.

More importantly, the continuation of policies inducing a decline in private investment would in the long run probably result in a deterioration of the Swedish economy. The failure to correct high cost conditions in export industries would lead to a further decline in exports and, possibly, the permanent loss of export markets to competitors. Swedish authorities maintain that they are fully cognizant of this danger but insist that increased public investments now will provide the basic prerequisites for long-run industrial expansion and for balanced economic development.

APPENDIX



Table 1

Commercial Banks Balance Sheets

(In millions of kronor)

| By Quarters | 1950 IV | 1951 I | 1951 II | 1951 III | 1951 IV | 1952 I | 1952 II | 1952 III | 1952 IV | 1953 I | 1953 II | 1953 III |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Cash & Riksbank deposits | 471 | 418 | 640 | 443 | 685 | 228 | 407 | 256 | 749 | 219 | 314 | 230 |
| Treasury bills & bonds | 1,107 | 1,182 | 1,238 | 1,706 | 1,849 | 1,945 | 1,597 | 1,838 | 1,715 | 2,279 | 2,386 | 3,163 |
| Due from banks | 424 | 347 | 419 | 436 | 388 | 370 | 376 | 446 | 355 | 366 | 391 | 427 |
| Total loans & credits | 9,240 | 9,723 | 9,896 | 10,052 | 10,175 | 10,334 | 9,988 | 9,901 | 9,848 | 9,897 | 9,821 | 9,929 |
| Total assets/liabilities | 11,951 | 12,176 | 12,815 | 13,253 | 14,044 | 13,448 | 13,018 | 13,048 | 13,537 | 13,249 | 13,503 | 14,424 |
| Deposits | 8,930 | 9,212 | 9,708 | 10,109 | 10,513 | 10,497 | 9,937 | 9,942 | 10,358 | 10,562 | 10,677 | 11,458 |
| Liquidity position 1/ | 17.7 | 17.4 | 19.3 | 21.3 | 24.1 | 20.7 | 20.2 | 21.1 | 23.8 | 23.7 | 25.3 | 29.6 |

1/ Ratio of Cash, Riksbank deposits, and government securities to total deposits.

Source: — Sveriges Riksbank, Annual Reports, Statistiska Meddelanden, Uppgifter om Bankerna.

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APPENDIX

Table 2

Effect of Riksbank Operations on Liquidity 1/

(In millions of kronor)

| By Quarters | 1951 I | 1951 II | 1951 III | 1951 IV | 1952 I | 1952 II | 1952 III | 1952 IV | 1953 I | 1953 II | 1953 III |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Foreign exchange transactions | – 137 | + 11 | + 508 | + 900 | + 33 | – 36 | – 66 | – 2 | – 38 | (+ 5) | (+ 178) |
| State institutions deposits (excluding clearing balances) | – 219 | + 139 | – 208 | + 297 | –383 | + 180 | + 184 | + 48 | + 106 | +68 | – 131 |
| Treasury bills & bond holdings | + 109 | + 165 | – 367 | – 530 | –382 | + 249 | – 211 | +763 | – 836 | +23 | – 38 |
| Loans and advances (Long-term deposits deducted) | + 77 | + 71 | —— | – 5 | +123 | – 21 | + 37 | + 54 | + 32 | – 6 | – 43 |
| Other | – 31 | – 25 | – 6 | + 16 | – 19 | – 65 | – 31 | + 39 | – 56 | (+19) | (– 11) |
| Total | – 201 | + 361 | – 73 | + 678 | –628 | + 328 | – 77 | +902 | – 792 | +109 | – 45 |
| Notes in circulation | – 158 | + 174 | + 106 | + 452 | –170 | + 178 | + 61 | +418 | – 265 | + 16 | + 38 |
| Demand deposits of banks at Riksbank | – 43 | + 187 | – 179 | + 226 | –458 | + 150 | – 138 | +484 | – 527 | + 93 | – 83 |

1/ (+) = increase in liquidity outside the Riksbank; (–) = decrease.

N. B. Figures in parenthesis estimated.

Source: — Sveriges Riksbank, Reports.

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APPENDIX



Table 3

Distribution of Bank Credit

| | In millions of kronor | | | | In per cent | | | |
|---|---|---|---|---|---|---|---|---|
| | Nov. 1951 | May 1952 | Nov. 1952 | May 1953 | Nov. 1951 | May 1952 | Nov. 1952 | May 1953 |
| Industry | 2,226 | 2,491 | 2,312 | 2,240 | 23.4 | 25.5 | 24.5 | 23.3 |
| Trade and Services | 1,985 | 2,050 | 1,881 | 2,134 | 20.8 | 20.9 | 20.0 | 22.2 |
| Communications | 244 | 283 | 276 | 297 | 2.6 | 2.9 | 2.9 | 3.1 |
| Insurance & credit institutions | 295 | 231 | 267 | 265 | 3.0 | 2.4 | 2.8 | 2.7 |
| Municipalities | 122 | 150 | 254 | 272 | 1.3 | 1.5 | 2.7 | 2.8 |
| Agriculture | 466 | 400 | 381 | 395 | 4.9 | 4.1 | 4.0 | 4.1 |
| Construction | 509 | 538 | 555 | 664 | 5.3 | 5.5 | 5.9 | 6.9 |
| Residential Housing | 2,532 | 2,490 | 2,444 | 2,334 | 26.5 | 25.4 | 25.9 | 24.3 |
| Personal & other | 1,165 | 1,153 | 1,061 | 1,015 | 12.2 | 11.8 | 11.3 | 10.6 |
| Total | 9,544 | 9,786 | 9,431 | 9,616 | 100.0 | 100.0 | 100.0 | 100.0 |

Source: -- "Affärsbankernas utlåning," Ekonomisk Revy, October 1953.

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Table 4

The Stock and Bond Markets

| By Quarters | Shares Index (1937=100) 1/ Bond | Industry | Turnover (In thousands of kronor) 2/ Shares | Bonds | Bond Yields (In per cent) Government 3/ | Industry 4/ |
|---|---|---|---|---|---|---|
| 1951 | | | | | | |
| I | 122 | 177 | 1,088 | 533 | 3.25 | 3.41 |
| II | 120 | 181 | 724 | 1,660 | 3.25 | 3.48 |
| III | 126 | 195 | 679 | 181 | 3.23 | 3.42 |
| IV | 124 | 195 | 656 | 208 | 3.20 | 3.30 |
| 1952 | | | | | | |
| I | 120 | 183 | 791 | 207 | 3.23 | 3.41 |
| II | 112 | 170 | 524 | 450 | 3.30 | 3.61 |
| III | 112 | 174 | 518 | 340 | 3.30 | 3.83 |
| IV | 111 | 167 | 498 | 193 | 3.30 | 3.62 |
| 1953 | | | | | | |
| I | 116 | 170 | 610 | 195 | 3.29 | 3.53 |
| II | 115 | 167 | 519 | 218 | 3.29 | 3.49 |
| III | 120 | 178 | 468 | 238 | 3.28 | 3.42 |

1/ Affärsvärlden: Average monthly.
2/ Average daily.
3/ Three per cent 1934 Perpetual Loan. Average monthly.
4/ Three per cent industrial bonds. Average monthly.

Source: — Kommersiella Meddelanden

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Table 5

New Issues and Redemptions of Bonds

(In millions of kronor)

| By Quarters | New issues | Redemptions | Net change in outstanding issues | | | |
|---|---|---|---|---|---|---|
| | | | State | Community | Mortgage banks | Other |
| 1951- I | 195 | 40 | + 27 | + 52 | + 63 | + 13 |
| II | 435 | 313 | + 26 | - 7 | +100 | + 3 |
| III | 225 | 557 | -488 | + 1 | + 72 | + 82 |
| IV | 201 | 46 | + 8 | + 62 | + 80 | + 5 |
| 1952- I | 622 | 122 | +411 | - 9 | + 84 | + 14 |
| II | 196 | 23 | + 10 | + 78 | + 69 | + 16 |
| III | 73 | 24 | + 5 | - 7 | + 58 | - 7 |
| IV | 195 | 45 | + 1 | + 62 | + 52 | + 35 |
| 1953- I | 1555 | 35 | +1374 | + 16 | + 63 | + 67 |
| II | 149 | 32 | + 3 | - 7 | + 62 | + 59 |
| III | 483 | 26 | +386 | - 7 | + 86 | - 8 |

Source: -- Kommersiella Meddelanden.

Table 6

SWEDISH

Government Finance
(In millions of kronor)

| | 1950-51 | 1951-52 | 1952-53p/ | 1953-54e/ |
|---|---|---|---|---|
| Current revenue | 5,820 | 8,007 | 8,275 | 7,660 |
| Current expenditure | - 5,449 | - 6,423 | - 7,875 | - 8,215 |
| Surplus/deficit on current account | + 371 | + 1,584 | + 400 | - 555 |
| Net capital outlays | - 568 | - 776 | - 967 | - 1,273 |
| Overall surplus deficit | - 197 | + 808 | - 567 | - 1,828 |

p/ Preliminary
e/ Estimated

NOTE: Revenues for 1951-52 — 1953-54 corrected to account for delays in disbursement of shares to municipalities.

Source: — Kommersiella Meddelanden.

Table 7

Gross National Product

(In millions of kronor)

| | At current prices 1950 | 1951 p/ | 1952 p/ | At 1951 prices 1950 | 1951 p/ | 1952p/ |
|---|---|---|---|---|---|---|
| Private consumption | 19,450 | 22,030 | 24,050 | 22,420 | 22,030 | 22,570 |
| Government consumption | 3,190 | 3,930 | 4,730 | 3,720 | 3,930 | 4,150 |
| Private gross fixed investment | 5,540 | 6,640 | 7,200 | 6,720 | 6,640 | 6,460 |
| Government gross fixed investment | 3,000 | 3,750 | 4,850 | 3,670 | 3,750 | 4,310 |
| Inventories | - 230 | 1,000 | 550 | - 250 | 1,000 | 500 |
| Net foreign investment | 190 | 950 | 130 | 1,930 | 950 | 660 |
| Exports and net services | (6,290) | (10,130) | (9,080) | (9,690) | (10,130) | (9,200) |
| Less Imports | (6,100) | ( 9,180) | (8,950) | (7,760) | ( 9,180) | (8,540) |
| G.N.P. (Market prices) | 31,140 | 38,300 | 41,510 | 38,210 | 38,300 | 38,650 |

p/ Preliminary

Source: Meddelanden från Konjuncturinstitutet, Konjunkturläget vaaren 1953.

NOT FOR PUBLICATION

February 9, 1954

The Act of Santiago and Economic Union Agreements of Argentina

Richard Kirby

Since early in 1953, Argentina has been negotiating certain bilateral economic agreements with various Latin American countries. The first country to join Argentina in these pacts was Chile with the signing of the Act of Santiago on February 21, 1953. This Act, which is a general declaration of intent embodying various economic objectives expected to be achieved by the signatories, has served as the basis for Argentina's negotiations with the other Latin American nations. In addition to these general objectives, the program contemplated under the Act provides for the negotiation of a Treaty of Economic Union, a Trade and Payments Agreement, and the establishment of a Joint Commission to make recommendations for the further implementation of the goals envisaged in the Act. Thus far, three countries have joined Argentina in bilateral agreements under this program, and at least four others are understood to be interested in similar arrangements. The countries that have subscribed to the Act are Chile, Paraguay and Ecuador; countries that have been approached by Argentina in this connection, but which have not yet subscribed include Colombia, Nicaragua, Bolivia and Peru.

In view of the apparent importance which Argentina attaches to these agreements, indicated by the efforts it is making to gain new signatories, it seemed advisable to review the nature of these agreements and the extent to which they have been implemented to date.

## Nature of the Agreements

All of these arrangements appear to conform to a common pattern. All involve adherence to the basic general agreement called the Act of Santiago; the negotiation of a Treaty of Economic Union; the appointment of a Joint Commission; and the negotiation of a Trade and Payments Agreement. As the basic general agreement, the Act of Santiago in each case sets forth the over-all objectives of increased reciprocal trade and economic development. Measures to reach these goals are agreed to in the treaties of economic union which provide for the gradual reduction of trade barriers, including the granting of tariff and exchange concessions, and the encouragement of reciprocal capital investment. Closely allied with these measures are the trade and payments agreements, which specify the commodities that are to be traded and the level of trade each way, and which also provide for swing credits varying in size with the amount of trade contemplated. In all of the trade agreements, the debits and credits for the transactions are to be carried in dollars instead of in Argentine pesos, although the use of the latter would seem to be more consistent with the role Argentina expects to play in Latin America.

## Extent of implementation of the Agreements

Chile - The Act of Santiago was signed by Chile and Argentina on February 21, 1953 and the Treaty of Economic Union on June 8, 1953.

A Joint Commission was established to make recommendations for implementation. In regard to a Trade and Payments Agreement, Argentina reached a tentative agreement last summer with Chile to trade 3 1/2 tons of wheat for 1 ton of steel, which was very favorable for Chile. Argentina had also agreed to trade 4 head of cattle for 1 ton of Chilean copper which was also favorable to Chile. Later in the year, however, Argentina demanded 1 ton of steel for 2 tons of wheat and 1 ton of copper for 3 head of cattle. This hardening of Argentina's terms was due to the less favorable world market for copper and steel, and has resulted in a temporary impasse as far as further implementation of the Act of Santiago is concerned.

Paraguay - More progress toward implementing the Act of Santiago has been made with Paraguay than with Chile, although the Act originated in the latter country. On August 14, 1953, Argentina signed the Act of Santiago and a Treaty of Economic Union with Paraguay. Following the establishment of a Joint Commission, Argentina negotiated a Trade and Payments Agreement with Paraguay calling for annual trade in each direction of $15 million which is double the present trade between these two countries. According to the agreement, the principal Argentine exports to Paraguay will be wheat ($10 million), cattle ($1.75 million), fruit ($0.25 million), and miscellaneous products amounting to $3 million. It is envisaged that Paraguay will ship lumber ($11 million) to Argentina, vegetables and essential oils ($1.2 million), yerba mate ($0.95 million), steel scrap ($0.4 million) and miscellaneous items amounting to approximately $1.5 million. Debits and credits for the transactions under the agreement, which provides for a swing credit of $5 million, are to be carried in dollars in accounts established in each of the central banks.

It is understood that the two countries intend to grant each other certain reciprocal exchange rate concessions. Rates are being modified largely in favor of Paraguay, although the agreed rates have not as yet been announced. In regard to the attitude of the Fund toward these concessions, which evidently involve discriminatory exchange practices between a member and non-member, it is not clear whether a violation of the Fund Articles of Agreement is involved. It is understood that this matter was taken up during the Fund's 1953 consultations with Paraguay, and that the staff report on the consultations is now under study by the Governing Board of the Fund.

In regard to the U.S.-Paraguayan trade agreement of 1946, it is indicated that no violation has occurred as a result of the Paraguayan arrangements with Argentina. Neither Paraguay nor Argentina is a signatory of GATT.

Ecuador - The most recent of Argentina's treaties of economic union under the Act of Santiago was negotiated with Ecuador in December 1953. This agreement has been implemented to about the same extent at that negotiated between Paraguay and Argentina; a Joint Commission has been established and a Trade and Payments Agreement has been signed.

Under the latter, Ecuador has agreed to export to Argentina: coffee ($2.5 million), cacao ($1.03 million), bananas ($1 million), and petroleum ($1 million). Principal Argentine products to be exported to Ecuador are wheat and flour ($1.5 million), cotton and wool ($0.5 million), edible oils ($0.4 million), oats ($0.4 million), and miscellaneous other products making a total of ($6.7 million), the same as the total value of imports from Ecuador. The agreement also provides for a swing credit of $1 million. In addition, Argentina has agreed to supply technical advice and one-half the capital necessary to build a new meat packing plant at Guayaquil.

Other negotiations - In view of current negotiations Colombia and Nicaragua will probably be the next to sign with Argentina. In addition, Argentina is understood to have approached Peru and Bolivia in connection with the negotiations of similar agreements.

Significance of the Act of Santiago

The agreements recently made in connection with the Act of Santiago are by no means without precedent in Latin America. The Treaty of Commerce of 1943 between Argentina and Paraguay contained many of the same objectives as the present treaty. It failed to attain its objectives through lack of cooperation on the part of both countries. Another example was the Argentina-Chilean economic and financial agreement of 1946 which also had lofty objectives beyond the immediate goal of increased trade. These objectives, however, have for the most part remained mere declarations of intent. In view of these precedents, it is rather doubtful that the objectives of the present understandings will be fully realized.

It may be presumed that the countries that have joined Argentina in the Act of Santiago expect to gain economically from the agreements. However, there are groups in each of the countries that have signed these agreements with Argentina, as well as in other Latin American countries, who take the position that such economic benefits may involve economic and political subservience to Argentina. Although the preamble to the treaties of economic union in connection with the Act of Santiago guaranty political sovereignty and economic independence, nevertheless, the fear of Argentine domination continues to constitute a significant obstacle to "economic union" with Argentina.