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Division of Research and Statistics
International Section

REVIEW OF FOREIGN DEVELOPMENTS

May 14, 1945

International Control of Shipping After V-E Day....1
 Monetary Coordination Among the Allies in Germany...4
 Currency Circulation and Bank Deposits in Italy...5
 United States Gold Coin Found in Germany.....6
 Lend-Lease Agreements with Belgium and the
 Netherlands.....7
 Economic Integration of North Italy.....8
 SUPPLEMENT
 The French Exchange Rate

Note

Miss Cornelia B. Roso, who until the present has edited the Review, has resigned from the staff of the Division of Research and Statistics. The original idea of the Review was hers and she has determined the character of the publication. To her goes most of the credit for the usefulness which it may have achieved so far. We wish to express our appreciation of the enthusiasm, judgment, and persistence which she brought to the undertaking. The editorial direction is now taken over by Mr. Charles R. Harloy.

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International Control of Shipping After V-E Day

J. Hans Adler

On or about June 1, a new international agency, the United Maritime Authority, will assume control of more than 75 per cent of the world merchant tonnage. The primary purpose of the new authority is the allocation of shipping space for military and civilian requirements during the war in the Pacific which poses, on account of the extended supply routes, the most difficult shipping problem, and the prevention of an uncoordinated discontinuation of shipping controls which may prejudice the post-war shipping interest of individual maritime countries. The United Maritime Authority will function until six months after the end of the war against Japan.

The United Maritime Authority was established, on a preliminary basis, at a conference last fall in London. An Agreement of Principles was signed by representatives of Belgium, Canada, Greece, the Netherlands, Norway, Poland, the United Kingdom, and the United States. Since that time France, Australia, and India have joined the agreement, bringing the number of signatory powers to eleven. Sweden was at first reluctant to enter into the agreement but the central shipping organization finally applied for membership subject to the approval of the Riksdag. This was interpreted by the signatory powers as a conditional consent and was refused. It is assumed that Sweden will shortly join the agreement without reservation.

The new Authority places control of merchant shipping on a general international basis and supersedes the organization of the Combined Shipping Adjustment Board which was set up early in 1942 to coordinate operations of the United States War Shipping Administration and the British Ministry of War Transport.^{1/} The American and British agencies controlled the merchant shipping of the other United Nations through charter agreements. A change in this procedure was deemed necessary because the charter agreements were due to lapse in some cases 30 days, in others 90 days, and in others six months after the end of the war in Europe. Norway, the Netherlands, and other countries were reluctant to consent to an extension of the existing arrangement under which they had no influence upon policy decisions. Their interest centers now upon the supply of relief and reconstruction goods to their home lands, and they have therefore insisted upon adequate representation on the policy-making body.

The United Maritime Authority consists of a Council in which all contracting governments are represented, and an Executive Board consisting of representatives of the United States, Great Britain, the Netherlands, Norway, and France. Other countries are entitled to representation on the Executive Board by an associate member. The Agreement of Principles declares that the contracting governments accept "as a common responsibility the provision of shipping for all military and other tasks necessary for, and arising out of, the completion of the war in Europe and the Far East and for the supplying of all liberated areas as well as of the United Nations generally and territories under their authority". The agreement also envisages the utilization of enemy shipping "to serve the requirements of the United Nations.....without prejudice to questions of disposition or title".

The most important provision with respect to the coordination of de-control of shipping is embodied in the agreement of the members "not to release from control any ships under their authority or permit them to be employed in any non-essential services or for any non-essential cargo unless the total overall tonnage is in excess of the total overall requirements, and then only in accordance with a mutually acceptable formula which shall not discriminate against the commercial shipping interests of any nation and shall extend to all contracting governments an equitable opportunity for their respective tonnage to engage in commercial trades".

^{1/} The Combined Shipping Adjustment Board will not be discontinued but will merely remain "dormant" as long as the U.M.A. functions. This is said to be necessary as a precautionary measure against a disruption of the U.M.A. controls.

The administrative agenda of the U.M.A., pertaining to the allocation of shipping to the various applicants, including UNRRA, the establishment of charter and freight rates, and the equitable distribution of cargo according to profitability among the vessels under the various flags, will be carried out, as before, by the U. S. War Shipping Administration and the British Ministry of War Transport. Special treatment is provided for coasting and short sea trades which are to be controlled by Zone Committees set up in London. Since the Coasting and Short Sea Trade Zones are located in the Baltic Sea and along the Atlantic coast as far as Dakar,^{1/} this appears to be a concession to the special interests of European maritime nations in re-establishment of their routes in that area.

The establishment of the U.M.A. gives adequate assurance that balance will be maintained in the allocation of shipping at the disposal of the United Nations between the military requirements of the war in the Pacific and the needs for relief and reconstruction in Europe, and that the dislocations which occurred after the last war as a result of the inadequate utilization of shipping will be avoided. That the merchant shipping of Russia, Latin America, Spain, and Portugal is not included in the pool is a minor deficiency since the utilization of this tonnage--with the exception of vessels engaged in coastwise and intra-neutral trade--will be largely determined by other forms of controls, such as those exercised by the Combined Raw Materials Board, the Combined Food Board, and general export control agencies.

The ultimate success of the U.M.A. will depend upon the ability to agree upon a "mutually acceptable formula" of de-control after V-J Day. As long as military operations continue, it is very unlikely that any surplus of shipping will accumulate. The real test of cooperation in the shipping field will come in the "six months thereafter" when the pressure of private ship operators on their respective governments for relaxation or modification of requisitioning schemes will be extremely strong. The United States is presumably more interested than any other individual nation in continuation of controls during the period when the return of several millions of American military personnel from the Pacific is to be accomplished. On the other hand, the European maritime nations will be eager to reassert their overseas shipping interests before the enormous volume of American shipping is released from military duty. Their consent to an equitable de-control formula will probably depend upon whether or not a general post-war shipping policy of the United States, acceptable to them, can be formulated and presented before or during the critical period of six months after V-J Day. In the meantime, notably Norway and the Netherlands are attempting to diminish their dependence upon American excess tonnage for the reconstruction of their merchant fleets through the placing of construction orders in Sweden and in this country.

^{1/} Other short sea trade zones agreed upon in principle are to be established for Malaya, the Dutch East Indies, and adjacent areas.

Monetary Coordination Among the Allies in Germany

H.J.D.

United States and United Kingdom forces have been using Allied Military mark notes in Germany since September 1944. It has recently become known that identical notes, printed in the Soviet Union, have been issued by the Russian armies advancing from the east. Coordination has also taken place with respect to the exchange rate. While the Western Allies are issuing the currency at the rate of 10 marks to the dollar (or 40 marks to the pound sterling), the currency is being placed in circulation by the Russians at the rate of 2 marks to the ruble. Military mark notes and ordinary German currency are circulating at par.

The new ruble-mark rate is consistent with the recently established rate of 10 marks to the dollar and a rounded off rate of 5 rubles to the dollar, which is close to the official rate of 5.30 rubles to the dollar prevailing since 1937 for evaluation of Russian foreign trade transactions. Had the exact rate of 5.30 rubles to the dollar been made the basis for the new mark rate, the latter would have been 1.886 marks to the ruble, an awkward rate for conversion purposes. The choice of rounded off figures, on the other hand, is a common practice in establishing exchange rates in the course of military operations.

Before the First World War, the ruble had an average value of 2.15 marks and before the Second World War a value of about .47 mark. With the outbreak of the German-Russian war in 1941, the Germans devalued the ruble to .10 mark. The ruble-mark ratio has therefore taken the following course:

1913 - 1 ruble =	2.15 marks
1938 - 1 ruble =	.47 mark
1941 - 1 ruble =	.10 mark
1945 - 1 ruble =	2.00 marks

As a result of these developments, the ruble-mark ratio of 1 to 2 prevailing before the First World War has been roughly restored.

On the basis of the new rate of 2 rubles to the mark and of the ruble rates established at earlier dates for the currencies of Poland, Rumania, Bulgaria, Hungary, and Czechoslovakia, it is now possible to compare the cross-rates for the mark in the Russian exchange rate system (which is likely to determine the actual exchange rates) with the earlier German rates and to show the degree of devaluation of the mark in terms of the different currencies:

	<u>German rate</u>	<u>Russian cross-rate</u>	<u>Devaluation of mark</u>
	1 mark =	1 mark =	in per cent
Bulgaria	32.78 lev	7.5 lev	77
Poland	2 zloty	.50 zloty	75
Czechoslovakia	10 koruny	2.78 koruny	72
Hungary	1.642 pengö	1.25 pengö	24
Rumania	59.88 lei	50 lei	15

As might have been expected, the devaluation of the mark in terms of the currencies of countries fighting on the Allied side or sympathetic to the Allied cause (Poland, Czechoslovakia, and Bulgaria) is very much greater than in terms of the currencies of Axis-Allied countries (Hungary and Rumania). This result was brought about by the action of Russia in devaluing the currencies of the latter to about the same degree as the mark while re-establishing the currencies of the former near their pre-war levels.

The new ruble-mark rate of 2 marks to the ruble paves the way for a homogeneous European foreign exchange rate structure. In the case of Germany, a rate was set both by the Western Allies and by the Russians, while in all previous cases either a dollar and pound sterling rate or a ruble rate had been set independently. As stated previously, the dollar-mark-ruble relation is based on the rate of 5 rubles to the dollar and it may be assumed that the latter rate, or a rate close to it, will also be the basis for the actual dollar rates to be established for currencies in eastern and southeastern Europe and for the actual ruble rates of the currencies in western and southern Europe.

Currency Circulation and Bank Deposits in Italy

J.H.F.

On the eve of the liberation of Northern Italy, the Italian Minister of the Treasury reported that the circulation in free Italy consisted of 176 billion lire of notes of the Bank of Italy and 52 billion of Allied Military notes, while the total circulation in the German-occupied provinces was estimated at 100 billion. At that time, free Italy had a population of about 30 million, the German-occupied territory one of about 20 million; thus the pre-capita circulation amounted to about 7,600 lire in free Italy, and about 5,000 lire in the German-occupied area. This difference was the more remarkable since the German-occupied territory constituted the richest parts of the country, the leading industrial areas in which per capita utilization of currency might normally be considerably greater than in the less advanced regions.

The most encouraging symptom of monetary confidence in free Italy was the increase in bank deposits since liberation. In the 50 free provinces, total deposits rose between the end of July and the end of December 1944 from 63.9 billion lire to 86.7 billion, the monthly rate of increase remaining practically constant at 4.5 billion. Almost 60 per cent of the rise concerned savings deposits. Thus almost all newly issued bank and IM notes found their way into deposits.

This development probably encouraged the Italian Government to announce on April 3, 1945, the offer of its first medium-term loan to the public, in the form of five-year Treasury notes. If this issue proves successful, the inflationary pressure of deficit spending certainly will be mitigated. Coming at a time when the issue of IM notes may be reduced substantially or even stopped completely, the floating of the loan should mark a long step forward on the way to rehabilitation of the Italian fiscal and monetary system.

United States Gold Coin Found in Germany

M.M.M.

The gold found in Germany by the Third Army has been the subject of considerable discussion in the press and elsewhere. The latest news is a story from Paris which quotes Colonel Bernard Bernstein, former Treasury expert, now with the Army Finance Department in Europe, as saying that the 200 tons of gold found at Merkers (approximately 200 million dollars) included an appreciable amount of United States gold coin and that this coin solves the mystery of what happened to gold coin of United States issue which was never turned in under the nationalization orders of 1933-34. According to the Washington Star of May 6, Colonel Bernstein said: "When the United States Treasury called in gold coin a few years ago, we did not get the quantity we expected from the amount that had been issued and were at a loss to know what happened to it. Well, now we know where a good deal of it was." The figure by which gold coin turned in before the 1934 deadline fell short of the estimated coin in circulation was 287 million dollars. The Treasury and the Board dropped this amount from the gold stock and from money in circulation as of January 31, 1934, when title to all gold in the United States was vested in the Government and private holdings became illegal. Subsequently this amount was excluded from the Board's record of gold stock and money in circulation back to 1913.

If Colonel Bernstein was quoted correctly, his conclusions may be questioned. Over the years the United States has kept records of the amounts of gold coin declared for export and import; and these data, as well as mintings and meltings, have, of course, been taken into consideration in formulating estimates of gold coin in circulation in the United States. The 1934 annual report of the Director of the Mint shows net exports of \$1,652 million for the fiscal years 1870-1934. The identification of the coin found in Germany as part of that which did not return from circulation in 1933-34 can only be based on the assumption, therefore, that the former is composed of coin never declared for export, i.e., mailed out or carried out. That there was such informal export is, of course, well established. Canada acquired United States gold coins in tourist and commercial traffic over the border, and United States gold coins were part of the gold stock of the Canadian banks turned over to the Bank of Canada in 1935. European countries torn by political and currency instability provided an avid market in the 'thirties. The nationalization of gold in this country in 1933-34 influenced many persons to mail out coin to relatives abroad who could get much more for it than could be obtained here by redemption at face value.

Even though we admit that this undeclared export of coins was substantial, it seems improbable that such coins should be concentrated in the hoard found at Merkers. To assume this would rule out the possibility that any of this coin was declared for export when it left the United States. Considering the number of countries the Germans occupied, it is fully as probable that declared exports figured to a large extent in the German accumulation. If this were not the case, we would have to assume that the declared coin exports to areas which were under German domination during the war disappeared into bullion or into channels the Germans could not reach.

Moreover, it appears unlikely that the coin not turned in for redemption in 1933-34 can ever be identified in large amounts. One reason for this is the possibility that much of this coin has been melted down because it is no longer as valuable as bullion. It would not be surprising, however, if small amounts were to come to light gradually from the liquidation of estates and general property of individuals in this country who held only a few pieces and so escaped official surveillance.

Lend-Lease Agreements with Belgium and the Netherlands

C.R.H.

The two Lend-Lease agreements signed during the past month--one with Belgium on April 17, the second with the Netherlands on April 30--resemble the French Agreement of February 28 in that they are based upon Section 3(c) of the Lend-Lease Act^{1/} and require monetary payment for supplies and services transferred after the President shall have determined that further deliveries are no longer necessary to the prosecution of the war. In all three of these agreements, payments may be made in 30 annual instalments with interest at 2-3/8 per cent on the unpaid balance. The recent agreements differ from the French Agreement in that they do not provide for delivery of long-life industrial and transport equipment such as is to be supplied under Schedule II of the earlier pact. Moreover, the agreements with Belgium and the Netherlands involve more moderate commitments (relative to the population or national income of those countries) than are involved in the agreement with France. The latter, it will be recalled, provides for goods and services to a maximum value of 2,575 million dollars while the two more recent agreements taken together list proposed deliveries valued at less than 570 million dollars. This difference in magnitude is doubtless explained both by the greater contribution which France has been able to make in the European fighting in recent months and by the larger role which that country is expected to fill in the Pacific war.

The two latest agreements are identical in all major respects except for the total value of the goods and services which the United States is tentatively committed to deliver and which the recipient countries are committed to accept. Supply schedules for the two countries are shown below in millions of dollars:

	<u>Metropolitan Belgium</u>	<u>Metropolitan Netherlands</u>
Raw materials	90,000	65,000
Food	75,000	70,000
Petroleum	14,000	10,000
Agricultural supplies	18,000	13,000
Clothing, footwear, and shoe repair materials	5,000	5,000
Medical supplies	1,500	5,000
Short-life equipment for industrial and transport facilities	77,000	47,000
Prisoner of war supplies	2,500	--
Freight charges on U.S. vessels	42,200	22,000
Total	<u>325,200</u>	<u>242,000</u>

^{1/} See R.F.D., April 2, 1945 for discussion of the French Agreement and of the terms of Section 3(c) of the Lend-Lease Act as amended. This section establishes a three year period after the expiration of the Act during which pre-existing contracts may be fulfilled.

While the schedules provide that the listed supplies are for the metropolitan areas only, a letter accompanying the Netherlands Agreement states that the United States is prepared to consider requests for essential supplies to be furnished for the Netherlands East Indies. Article IV, identical in both agreements, provides for revision of the schedules by mutual agreement between the parties and is interpreted to mean that "not only the items but also the values expressed for each item in the Schedule and the total value expressed for the whole Schedule" may be modified. As in the French Agreement, the United States retains the right to withhold delivery of any supplies or services should the President determine this to be in the national interest; Belgium and the Netherlands may be released from their respective obligations to receive any of the specified products upon payment of net losses incurred by the United States as a result of such action.

Reverse Lend-Lease agreements with both countries are continued and are extended to provide that mutually agreed-upon amounts of strategic materials from the Belgian Congo and the Netherlands East Indies shall be furnished to the United States by the Belgian and Dutch Governments, respectively.

Economic Integration of North Italy

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The German collapse in Italy has set the stage for resumption of the long-interrupted economic intercourse between the northern provinces and the rest of the country. Since, however, the immediate renewal of normal trade relations between the two regions would introduce serious economic disturbances because of the wide divergence of economic conditions in the North and South, the Italian Government in Rome and the Allied Commission have adopted a plan whereby it is hoped that the re-absorption of the North into the national economy can be accomplished in a gradual and orderly manner. Trade and financial transactions between the two areas will be closely controlled to prevent disruptive and speculative inter-regional movements of goods and currency until such time as the price and wage levels of the North and the South have become more nearly comparable. The authorities have announced, however, that the de-facto blockade will be lifted as soon as possible.

For at least eight months all economic relations between the northern provinces and central Italy have been suspended; economic contacts of the North with southern Italy, Sardinia, and Sicily have been interrupted for a considerably longer period. Regional disparities, which had begun to develop even before the Allied invasion of southern Italy, reached serious proportions during the period of divided economic and political control of the North and South. Although economic data on comparative prices are fragmentary and unreliable in view of extensive black market operations and regional disparities in each of the larger areas, one may venture the guess that price and wage levels in the South are two to three times as high as in the North. Smaller discrepancies exist in security prices and in the volume of note circulation; supply conditions vary considerably, permitting a substantial disparity in

consumption standards in favor of the northern area which has, of course, for many years contributed the major share of Italian production. Resumption of trade between the two areas will present the same types of problems as will arise in restoration of trade between separate countries which have experienced varying degrees of inflation during the war. In the latter instance, however, rough adjustments may be made through the medium of changes in the exchange rate between the currencies involved. This method is precluded in the Italian situation since the bulk of the currency circulating in the two areas is identical in form.

Under these conditions it is probable that abrupt resumption of completely uncontrolled economic relations between North and South would result in chaotic movements of goods and currency in a manner which might contribute to a further decline in national production or greatly hamper the rehabilitation of the Italian economy. Price and wage levels would tend to move toward equalization at the cost of irregular inflation in the northern provinces as the southern regions attempted to exchange their depreciated lire for northern goods. There would be increasing danger of labor unrest in the industrial regions of the North where proletarian political influence is strongest. Under existing conditions of serious transport shortages, disposition of the limited quantities of goods which can be transferred cannot safely be left to the dictates of speculators or profiteers. Until goods begin to move in sizeable volume across the economic boundary line to be established, prices in the North can be expected to remain lower than elsewhere in spite of the now inflationary effects which may be expected from expenditures by Allied troops stationed there. This effect will be offset to some extent by the cessation of German army spending and may, indeed, be negligible if occupation forces are small.

The fusion of separate economic administrative arrangements will not be without difficulties. Many independent changes have been made in the tax systems of the two areas; government administration of national banking institutions has been reorganized by the government in Rome and applied thus far only to its area of responsibility; price control and rationing administration have developed independently during the past year or so; integration of the management of industrial, commercial, and banking firms of nation-wide scope will have to be achieved; the untoward movement of banking funds across the boundary line will have to be prevented. In the North alone a number of industrial establishments and other businesses have been "nationalized" and put under the control of employees and the State as well as of employer representatives. The question of abolishing this nationalization or carrying it into effect throughout the country is obviously of great political significance. The absorption of northern political leaders into the Italian Government, whether in a Cabinet under Premier Bonomi or under new leadership, also bears upon the speed and conditions of the economic integration process, particularly as to the degree of cooperation political leaders give to the two-way flow of goods between the two areas.

Once political and economic cohesion has been achieved, national policy will have to be reformulated with respect to foreign exchange rates, to the resumption of large-volume foreign commercial traffic, and to financial transactions with foreign countries, including debt transactions.

The French Exchange Rate

Hans J. Dernburg

Summary

The French exchange rate of about 50 francs to the dollar has been set at a relatively high level, the devaluation of 12 per cent against the pre-war rate being rather slight in view of comparative price developments. During the war and the immediate post-war period, a high franc rate has definite advantages for the French economy. Not the least of these is the tendency of the new rate to curtail expenditures by Allied troops and accordingly to conserve scarce food for the native population. Needless to say, this policy finds little favor with British and American soldiers located in France. Until normal international trade can be resumed, the exchange rate will have little practical significance in terms of the competitive position of France in world markets. It is probable, however, that the war-time rate for the franc will prove far too high when France seeks to resume her export trade and to attract foreign travelers. If prices in France remain at their existing level or rise further, the rate of exchange may have to be lowered to 100 or more francs to the dollar to enable the French to compete on equal terms in world markets. It may be difficult to engineer such a reduction, not only because of political and psychological considerations but also because the present rate has already become embodied in agreements with other countries.

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The new rates for the French franc of about 50 francs to the dollar and about 200 francs to the pound^{1/} compare with a pre-war rate of 43.8 francs to the dollar and 176-5/8 francs to the pound. There is general agreement that this rate will prove too high when international trade is resumed, since the devaluation of some 12 per cent does not take sufficiently into account the fact that war-time price inflation has progressed in France further than in other countries. This is brought out in a careful study prepared in Paris under date of February 19, 1945. The author bases this estimate on a corrected pre-war ratio of 39.42 francs to the dollar.^{2/} Since prices in major French consumption centers are about 238 per cent above pre-war levels, and prices in the United States and England have risen by about 30 per cent above pre-war level, he concludes the present purchasing power parity rate would be 103 francs to the dollar. At this rate the franc would be about half the official rate. Because of the abnormal transportation situation, however, there has been an unusual distortion of prices in consumption centers. The study assumes that an improvement of the transportation situation would somewhat lower the price level, but would still leave prices about 200 per cent above the pre-war level. With normalized internal transportation, the purchasing power parity rate may go down, according to the report, from 103 francs to the dollar to 91 francs to the dollar, but even on this basis the franc would be 82 per cent cheaper than at the existing official rate.

^{1/} The exact dollar rates of the Bank of France are 49.53 francs for buying and 49.72 for selling; the exact rates for the pound sterling are 199-7/8 francs for buying and 200-1/8 francs for selling.

^{2/} Assuming that before the war the franc was undervalued by as much as 10 per cent, the author corrected the pre-war rate of 43.80 to 39.42.

Following the landing of Allied troops in French North Africa in November 1942, a rate of 75 francs to the dollar (or 300 francs to the pound) was established for French North Africa. As a result of strong French representations at the Casablanca Conference, these rates were modified, beginning on February 2, 1943, to 50 francs to the dollar (or 200 francs to the pound), which implied an upward revaluation of the franc by 33 per cent. A Franco-British Agreement concluded one year later on February 8, 1944, extended the latter rates to the other parts of the French Empire under de Gaulle which until then had belonged to the sterling area and where the pre-war rate of exchange of 176-5/8 francs to the pound had been maintained during the whole course of the war. With the invasion of metropolitan France in June 1944, military franc currency was issued there and after consultation between Allied authorities and the French Committee of National Liberation the new colonial rates of 50 francs to the dollar and 200 francs to the pound were applied to metropolitan France. Subsequently the French Committee was recognized as the de facto authority in France and as the Provisional Government of the French Republic, and by the end of August an agreement was signed between the United States and British Governments on the one hand and the French Provisional Government on the other, granting the latter complete authority over the issue of currency in liberated France. The agreement was made retroactive to D-day, and therefore the Provisional Government assumed responsibility for the issue of all the military franc currency issued since D-day. Theoretically since D-day and in practice since the end of August, the French Provisional Government has sole responsibility for all monetary affairs in France including the exchange rate.

It has been suggested that the fixing of the exchange rate of a liberated or occupied country might be guided by an estimate of the depreciation of its domestic purchasing power as related to a pre-war base, compared with the rise of prices which has occurred in the United States, Great Britain, and in contiguous countries. There is, of course, the technical difficulty of ascertaining the purchasing power of a currency, when index numbers are based on controlled prices and while black market buying is widespread. Aside from these difficulties, it may be asked whether in fixing foreign exchange rates during the phase of military occupation, it is really necessary to base the exchange rate on international price and cost relationships. Regular foreign trade, tourist traveling, and other current transactions which normally enter the balance of payments of a country are practically absent during military occupation. There seems to be practically only one important item worth consideration, namely the expenditures of the occupying troops. For these an exchange rate is to be established but it is irrelevant whether, at that rate and the prevailing international price and cost levels, foreign trade, tourist travel, etc. could be carried on successfully. The question might be thought to be only how much purchasing power should the occupying soldier receive in terms of domestic currency and what should be his share in the very limited supply of local goods.

While international price and cost relationships need not necessarily be taken into account in establishing exchange rates for the phase of military occupation, there are good reasons for not disregarding them altogether. Once established, an exchange rate is likely to be left unaltered for political and psychological reasons. The rate established in the period of transition is therefore likely to be the rate which the country would want to maintain when normal trade is to be resumed. If in establishing the rate international price and cost relationships and trends are completely disregarded, the rate established in the period of transition may prove too high when more normal conditions are restored, and may be a serious handicap to exports, forcing the country possibly to undergo a serious deflation or to introduce foreign exchange restrictions, subsidize exports, etc.; or the rate may prove too low and constitute an unhealthy stimulant to exports, leading to a "clearance sale", necessitating measures to curtail exports, etc. In either case unhealthy economic conditions would prevail until the necessary price and cost adjustments have taken place. It is for these reasons that, in establishing exchange rates for the period of transition, international price and cost relationships and trends should be taken into account.

The ultimate determination of the French price level depends on a complex of factors in the fields of finance, production, and trade. When the rate of about 50 francs to the dollar was established, the French Provisional Government was still planning the sort of deflationary program actually carried out in Belgium. These plans were completely abandoned and the French Government instead launched a large Liberation Loan to absorb purchasing power (which has been moderately successful), increased existing taxes and introduced new ones (capital levy). It is highly significant that, because of increased military expenditures, the 1945 budget of 400 billion francs will create a greater deficit than in the years when France had to pay occupation costs. Much confidence is being placed in the reconstruction of the French transportation system and, in the longer run, in increased production and imports. It is difficult to forecast what the combined result of all these developments will be, but because of the continued government deficit it seems likely that price inflation will continue for some time and that the existing official rate will overvalue the franc still further for the purposes of international trade.

The relatively high exchange rate of about 50 francs to the dollar would have made sense as a long-term policy if--as originally intended--it had been accompanied by a firm internal deflation program. As it is, it can be defended as a war-time expedient from the standpoint of the French national interest for the following five reasons.

(1) In the ten years preceding the war, the French franc was devalued several times. It is understandable that the de Gaulle Government in returning to France did not want to start out with a considerable devaluation of the franc. This explains why the French Government strongly defended the franc at the Casablanca Conference and induced the Allies to revalue it from 75 francs to the dollar to 50 francs to the dollar.

(2) When the rate was established, little was known about economic conditions and future price trends in France. Since a rate that would accurately fit the future international trade position of France could not be established anyhow, it was preferable to set a rate that might prove too high rather than too low. A future correction by devaluation would cause less friction than an upward revaluation.

(3) The rate chosen curtails the purchasing power in the hands of Allied soldiers more than, say, a rate of 100 francs to the dollar. In comparison with such a rate it minimizes the inflationary impact of Allied troop spending. Of all the economic arguments advanced in favor of the present rate, this argument is certainly the strongest. For Italy an exchange rate had been established which undervalued the lira in terms of existing prices, and the ample purchasing power in the hands of Allied soldiers certainly operated to drive up prices there. Had too low a value been placed on the franc, the liberating armies would probably have been accused of causing inflation in France.

The relatively high rate curtails soldier spending in terms of francs and thus minimizes its inflationary effect. It is just this condition which has created some friction. American soldiers stationed, or on furlough, in France complain about the high prices in the metropolitan centers and accuse the French of "exploiting" them. There have been reports from Paris of modest meals costing 250 francs, equivalent to 5 dollars, and of good dinners costing 1,000 francs, equivalent to 20 dollars.

It should not be forgotten that there is an extreme scarcity of food in the metropolitan centers, caused in part by the disruption of the French transportation system. Allied soldiers are well supplied by their own canteens and it has been the official policy that they should spend in France as little as possible in order not to intensify the shortages of local supplies and the inflation problem. In view of the French shortages, it is perhaps reasonable that American soldiers should pay much higher prices for what they purchase in France than for what they purchase in the United States, where supplies are comparatively abundant. In practice, the problem will become less acute with a general improvement of the French transportation system and by the fact that with the Allied advances into Germany, more and more troops will be stationed in Germany rather than in France.

(4) France is acquiring dollar and sterling exchange for the net amount of currency disbursed to the American and British troops. At a relatively high exchange rate France is acquiring foreign exchange rather cheaply. With respect to reciprocal lend-lease, the rate has the advantage for France that she is credited for her outlay in francs with relatively high dollar equivalents.

(5) In the first post-war years, France is faced with a period of heavy imports while sizeable exports are not yet forthcoming because of the decrease in production. In this period France will have to fall back on her gold and foreign exchange reserves, most of which

were kept intact during the war. France would secure, of course, the same amount of foreign goods whether the exchange rate is high or low, but at a high exchange rate imported goods enter the country at relatively low franc values and this may have a beneficial effect on the French price level.

From the preceding arguments it will be seen that the established rate makes a good deal of sense from the French national interest, especially as a war-time expedient. In the long-run, however, the maintenance of the relatively high rate may prove dangerous. When the period of one-sided imports is over and France desires to resume her export trade and to attract travelers, she should not hesitate to devalue the franc substantially. With the establishment of the International Monetary Fund there would be an opportunity to make the necessary adjustment. There is, of course, the danger that the franc set at a relatively high level for political and psychological reasons, may be kept at that level for the same reasons. France has already concluded monetary agreements with the United Kingdom, Belgium, and Switzerland on the basis of the new rate and there is danger that the rate overvaluing the franc will perpetuate itself. The example of Germany after 1931 illustrates what abnormal conditions develop when a country attempts to maintain an overvalued currency.

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