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Cheap Money in France — Bruno Foa

Cheap money has been adopted as the official policy of the French Government, according to a statement of January 22 by Finance Minister Pleven. The announcement was implemented by a further reduction in the Bank of France discount rate to 1.625 per cent from 1.75 per cent and by the conversion of a number of old 4 per cent and 4½ per cent loans into a new 3 per cent issue.

These recent moves involve no departures from the policies practiced during the occupation years by the Vichy regime or those adopted thus far by the de Gaulle Government. Ever since the Summer of 1940, the plethora of liquid funds originating from German expenditures from occupation-cost levies had produced a continuous and steady fall in interest rates. It was only natural that the Vichy Ministers of Finance1/ should take advantage of that state of affairs to effect large-scale conversion operations on rentes and other long-term securities, and to sell Treasury bonds and bills at lower interest rates. As early as 1942, the Bank of France rate was reduced to the all-time low of 1.75 per cent at which it remained until last month.

The cheap money policy has already paid very substantial dividends, for while the total of the national debt has increased from 445.7 (end of 1939) to some 1,650 billion francs (September 1944), namely by approximately three and a half times, the interest charge has only increased from 21 to some 30 billion francs, or by

1/ It may not be without interest to point out that two of the Vichy Ministers of Finance had been, before the war, very close to M. Paul Reynaud, who had been a consistent advocate of cheap money contrary to the dominant opinion of the 'thirties.

a little less than 50 per cent. It is true that this was due to a certain extent to the great increase in the volume of Bank of France advances, which are interest free.[1/] Considerable saving, however, did result from lower interest rates, as during this period, the interest-bearing part of the national debt increased from 409.6 to 1,142 billion francs, i.e., by almost three times.

It is also clear that cheap money is essential to permit the orderly financing of the borrowing requirements of the French Government which will be large for some time to come. No budgetary estimates have as yet been published for the current year, but credits aggregating 58 billion francs for the civil services and 43 billion for national defense have been appropriated for the first three months only. Projecting those appropriations, total expenditure for the year would reach 400 billion francs. On the somewhat optimistic assumption that revenue can touch 150 billions, this would leave a deficit in the order of 250 billion francs (as compared with 28 billion for the last pre-war year), to be covered by borrowing. Moreover, the French Government will have to face, for a number of years, the huge expenditure involved by reconstruction,[2/] which calls almost inevitably for further large-scale borrowing. Given these prospects, low interest rates are imperative in order to establish an equilibrium relationship between the public debt charge and the national income and at the same time in order to avoid the necessity of a too drastic ultimate devaluation of the franc.[3/] They should also help to revive investment and employment during the reconstruction period.

According to newspaper dispatches, the French Government, by committing itself to cheap money, has strengthened the hand of M. Pleven and others in the cabinet who favor a "conservative" approach to the nation's financial problems, against M. Mendès-France and others who favor radical solutions. It is curious that what is meant by "conservative", in that context, is a policy which has

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1/ Those interest-free advances from the Bank of France measured to a large extent the gap between expenditure resulting from occupation costs and the sales of securities, and resulted in large-scale paper inflation.

2/ The Ministry of Reconstruction and City Planning has recently announced plans which call for the expenditure of the sum of 1,000 billion francs over seven to ten years for the reconstruction of a number of war-devastated towns and of hundreds of villages. The actual amounts involved will, of course, depend on the future level of French prices, but in any case will be enormous.

3/ In itself, the present burden of the interest charge does not call for a drastic fall in the domestic value of the franc, with respect to the pre-war price level and corresponding money value of the national income. Prices have, of course, run considerably out of hand, and are reported to be already several times higher than in 1939. In the present circumstances, therefore, it is the outright runaway trend of prices, and not the state of public finance or the amount of the public interest charge, which threatens the ultimate value of the franc. If prices could be stabilized at something around their present level (which is said to be from 3 to 6 times higher than that of 1939), the public interest charge would be no problem even if it should double within the next five or seven years.

traditionally been considered as expansionary, if not outright inflationary, and that deflation is described as the "radical" policy. In all this there appears to be a certain degree of confusion between short-term and long-term policies and issues. Insufficient information is available here as to the exact nature of the controversy between M. Mendès-France and M. Pleven, but it would probably be unfair to assume that the former advocates deflation and the latter expansion (or "inflation") as a long-term policy. It appears that M. Mendès-France advocated, among other things, a drastic program of sterilization of currency and bank deposits along the lines of the Belgian experiment, while M. Pleven opposed this and sponsored a more gradual approach toward the problem of mopping up excess currency. Once more it is impossible from this distance to appraise dispassionately the merits of the two viewpoints, since this would require a detailed knowledge of all the relevant facts of the present French situation. It can be pointed out, however, that a once-for-all measure of deflation would by no means be incompatible with a policy of cheap money and gradual income reflation, provided of course the appropriate controls over prices and consumption expenditure are effectively enforced. In any case, a reversal of the cheap money policy, while adding immeasurably to the difficulties of the Treasury, would in the circumstances make no contribution to the problem of inflation control, for which the solution is at present one of supplies, transportation, and price and other regulatory measures.

For many years after the war government borrowing will dominate the French financial market to an even more marked extent than it had during the inter-war decades. In the circumstances, the primary responsibility for the setting up and maintenance of an appropriate structure of interest rates will fall on the Treasury. This will involve, among other things, narrowing the gap between short-term and long-term interest rates and a steady fall in the latter. The Bank of France and the commercial banks should of course cooperate in full. A situation such as that of the 'twenties, when the Bank could indulge in the disastrous luxury of a wholly independent policy and even threaten the Government of the day with "bankruptcy" is altogether unthinkable in the future. According to recent reports, a quite considerable Treasury bill market has developed in Paris to meet the stress of wartime finance, and this should be of help to both the Treasury and the Bank of France in implementing their joint operations.

Monetary Developments in Liberated Poland — Hans J. Dernburg

The liberation of most of the territory of the Polish State coinciding with the announcement of far-reaching monetary measures inaugurated by the Polish Provisional Government, first in Lublin and now in Warsaw, directs attention toward the complicated monetary situation prevailing on Polish territory.

Before the war the Bank Polski in Warsaw, the Polish central bank, was the only note issuing institution in Poland. With the German occupation of Poland in 1939, the Bank Polski ceased to operate on Polish territory. At the end of 1942, before the great Russian drive westward, there were circulating on former Polish territory four different currencies: those issued by the Deutsche Reichsbank, the Emissionsbank in Polen (Cracow), the Zentralbank Ukraine (Rovno), and the Reichskreditkasse (Berlin), all of them German or German-sponsored institutions.

(1) In the western territories of the Polish Republic which were annexed in 1939 by Germany, the zloty currency of the Bank Polski was exchanged for reichsmark currency at the rate of 1 zloty for 0.50 reichsmark representing a slight appreciation of the zloty, the pre-invasion rate being 1 zloty = 0.47 reichsmark. The incorporated territories also include the Bialystok area, which was first annexed by the Russians and then, in 1941, incorporated into East Prussia by the Germans. In the same year the ruble currency in this region was exchanged for reichsmark currency at the rate of 10 rubles to the reichsmark. The rate compares with a pre-war rate of 2.10, the devaluation of the ruble amounting to almost 80 per cent.

(2) In that part of Poland which became the Government General with its capital in Cracow, a new central bank, the Emissionsbank in Polen (Bank Emisyjny w Polsce) was established and put into operation in early April 1940. The bank issued a new type of zloty currency, which was exchanged for the old zloty currency of the Bank Polski at the rate of 1:1. After the outbreak of the German-Russian war, the District of Galicia with its capital at Lwow was added to the Government General, and the note issue of the Emissionsbank was extended to that area. Zloty currency was exchanged for the ruble currency, introduced at the time of annexation to Russia, at the rate of 1 zloty for 5 rubles, a rate based on the ratio 1 reichsmark = 2 zloty = 10 rubles.

(3) The middle part of eastern Poland with its center at Rovno, previously annexed by Russia, became part of the newly established Reichskommissariat Ukraine, after the outbreak of the German-Russian war. Here the Russian ruble and Reichskreditkasse currencies were exchanged for the karbovanetz currency of the new Zentralbank Ukraine in Rovno at the ratio 1 karbovanetz = 1 ruble = 0.10 reichsmark of the Reichskreditkasse. The mark currency of the Reichskreditkasse is at par with Reichsmark currency.

(4) The northeastern part of Poland with its center at Wilno, previously annexed by Russia, was made part of the Reichskommissariat Ostland (consisting mainly of the former Baltic States) after the outbreak of the German-Russian war. In that area the ruble currency was replaced by notes of the Reichskreditkasse which became the only circulating means of payment. The exchange took place at the rate of 1 reichsmark = 10 rubles.

With the reconquest of eastern Poland and of the District of Galicia by the Russian armies, it seems probable that the ruble was reintroduced there, since Russia does not expect to return these territories. When Russia annexed them from Poland in 1939, the zloty currency of the region was repudiated and it may be concluded from past experience that the currencies which before the reconquest by the Russians circulated in the area (karbovanetz, Reichskreditkasse notes and zloty of the Emissionsbank) shared the fate of the original zloty currency.

In the territories of the Government General, the advancing Russian armies introduced military zloty and ruble currency, the ruble being given its pre-war value of 1 zloty. The new currencies have thus been circulating at par with the zloty notes of the German-sponsored Emissionsbank in Cracow. A decree of January 15, 1945, issued by the Polish Provisional Government (at that time still in Lublin) declared invalid the zloty notes of the Cracow institution. Under the decree, individuals may exchange up to 500 zloty of the Cracow institution at par for the money of a new central bank, the National Bank of Poland. Higher amounts will be exchanged for private firms, governmental organizations, charitable and similar organizations. The excess balances, for which no new notes are exchanged, are to be deposited with the State, and it was officially announced that they might be redeemed later. The penalty for violation of the decree is a fine up to one million zloty. The decree of January 15, 1945, also provided for the unlimited exchange of Soviet currency (issued by the Russian troops) for notes of the new National Bank of Poland until July 15, 1945. Thus after July, notes of the National Bank of Poland will be the sole legal tender in the territory of the Polish State.

The withdrawal of the notes of the Cracow institution is to be considered as a strict deflationary and possibly anti-capitalistic measure. It was reported that its immediate effect was to bring commerce to a virtual standstill. The measure forecasts the end of the German-sponsored Emissionsbank in Polen and of its note issue. The institution had started out with a note issue of about one billion zloty, which it issued in exchange for the zloty notes of the Bank Polski circulating in the area of the Government General, and with certain deposit liabilities which originated from the deposit with the bank of zloty notes of the Bank Polski withdrawn in the areas annexed from Poland by Germany. Since the Emissionsbank did not acquire corresponding assets from the Bank Polski, it was authorized to back its notes and deposit liabilities--on the pattern of the German Rentenbank of 1923--by a global mortgage on the entire real estate of the territory up to a maximum amount of 3 billion zloty.

Discounts and loans, German money, and claims against the German Reichsbank and the German Clearing Office might be counted as additional note cover. No statements of the institution have been published by the Germans. Its note issue has been estimated recently at 15 billion zloty, a figure which probably greatly exaggerates the expansion which took place under occupation.

No information has been released on the intentions with respect to the Bank Polski, Poland's original central bank. After the German invasion, the administration of the institution fled the country, first to Paris and later to London, where it is maintaining offices. It has claim to the substantial gold holdings of the Bank Polski which were shipped abroad in 1939 and which, after dangerous odysseys, are now all under Allied control. An amount of one billion zloty of its notes are said to be in the possession of the Polish Government in London.

Deficit Finance in Belgium

The stabilization program of the Belgian Government is being threatened not only by the continuing scarcity of commodities, but also by the unsatisfactory state of the country's finances. The budget estimate for the first quarter of 1945, recently submitted to the legislature, provides for expenditures of 3.2 billion francs a month, of which 1 billion represents expenditures for the Allied forces under the Mutual Aid program; reimbursable advances to the Allies apparently have not been included in that sum. Expenditures have decreased by 0.7 billion a month since the first quarter of 1944. The drop, however, is due entirely to the fact that the expenditures for the Allied forces are lower by 1.1 billion a month than the occupation costs which Belgium had to pay to the Germans. Civilian expenditures have risen by about 0.4 billion a month because of the increase in salaries and "social expenditures". No estimate of revenues is available. They amounted to about 1.4 billion francs a month during the occupation, but have decreased substantially as a result of the economic stagnation brought about by the military events and the deflationary policy of the Government. The budget deficit is being covered by the issue of Treasury bills. The scarcity of cash prevents private investors and commercial credit institutions from investing in these bills out of their own funds, and the bulk probably is being taken over, directly or indirectly, by the central bank. It may be estimated that central bank credit is increasing at a rate of more than 2 billion francs a month. This rise is about as large as it was under the German occupation, and is bound to have similar effects. The Government plans to balance the budget by a severe tax upon war profits, but the legislature so far has not passed the necessary measures.

(The official value of the Belgian franc is 2.28 U.S. cents.)

J.H.F.

British Attitudes Toward Free Trade

Lucy Axelbank and
Lloyd A Metzler

The outstanding feature of British commercial policy in the inter-war period was the abandonment of free trade. Simultaneously there was a trend away from controlled trade in the United States. As a result of these diverse developments, the post-war commercial policies of the United Kingdom and the United States probably will depart still further from their historic lines. The United Kingdom, traditional advocate of free trade, will be a highly-protected country, while the United States, traditional high-tariff country, will be an advocate of fewer trade restrictions.

After the war, both countries are committed, through the Lend-Lease Agreement, "to the elimination of all forms of discriminatory treatment in international commerce, and to the reduction of tariffs and other trade barriers". Nevertheless, it would be foolish to suppose that the United Kingdom can be easily pursuaded to abandon the system built up before the war. Indeed, it seems almost certain that discriminatory and restrictive trade policies will not be abandoned unless the economic conditions which led to their adoption are altered. This becomes abundantly clear from an examination of current British publications. Opposition to post-war tariff reductions, and to the elimination of bilateral methods, is widespread among both liberal and conservative groups.

In general, three types of argument are presented. First, it is said that discriminatory methods are necessary to enable the United Kingdom to balance its international accounts, without reducing the standard of living. The opinion is frequently expressed that post-war pressure on the pound sterling cannot be removed except by balancing trade bilaterally. Non-discriminatory methods, such as exchange depreciation or reduction of tariffs in the United States or creation of higher income levels in the United States, are considered inadequate to give the United Kingdom an even balance of payments.

Second, bilateral trade agreements are advocated to enable the United Kingdom to pursue "full employment" policies without hindrance from depressive influences abroad. In particular, it is believed that discriminatory practices will enable the Empire to isolate itself from expected post-war fluctuations of income in the United States. From this point of view, discrimination is held to be beneficial both to the United Kingdom and to the rest of the Empire, since it provides more stable markets for all concerned.

According to the third argument, a return to free trade would make it impossible for the United Kingdom to use the large British demand for imports as a bargaining weapon. If all other countries were economically "disarmed" at the same time, the loss of bargaining power might not be serious. However, it is pointed out that even if trade restrictions and bilateral arrangements are reduced uniformly, the United States will retain an important weapon, in the form of its lending power, which it might use to force British exports out of competitive markets. Retention of bilateral methods is therefore held to be essential for equitable bargaining power.

Between the advocates of continued bilateral methods and the advocates of free trade, many different shades of British opinion may be found. These variations are not related in any distinct way to basic political philosophy. Nevertheless, a few broad generalizations may be suggested. In the first place, most of the advocates of free trade, a small minority in any case, are to be found among members of the Liberal party. Other middle-of-the-road groups, while opposed to continued use of bilateral methods, wish to retain the privilege of reintroducing them in case of necessity. At the extremes of conservatism and radicalism, opinion is predominantly in favor of continuing the use of bilateral methods. In its May 1942 report, the Federation of British Industries said:

> "... the view is widely held in industrial circles in this country that we must, at any rate for some considerable period, rely upon a policy of directed imports, on the assumption that we only import from overseas countries those essential commodities for which such overseas countries are prepared to accept payment by the only means which will be open to us -- i.e., by the export of our own products ..."

This argument in favor of bilateral methods seems to typify the opinion of most British industrial groups. Among businessmen generally, the only vocal advocates of a contrary view--i.e., the only free traders--are the banking and financial leaders. The Financial News for October 31, 1944, expressed the opinion "... they /bilateral arrangements/ obviously cannot permanently bolster up a situation which is inherently and fundamentally unsound." Thus, many banking leaders feel that bilateral methods are not a genuine solution to the British problem but only emergency measures.

Leftists and labor leaders in the United Kingdom are as much opposed to unconditional acceptance of free-trade principles as are business and industrial leaders. Typical of British left-wing opinion is a statement in the New Statesman and Nation for October 2, 1943. Discussing the question of bilateral dealing, this journal says: "We must beware of being lured ... into throwing away incautiously an instrument without which we shall be unable to maintain either 'full employment' or a satisfactory standard of living for our people".

Thus on the question of post-war commercial policy, a considerable measure of agreement between left-wing political groups and business leaders is apparent. Bilateral methods are approved by both extremes. Consistent support for the principles of free trade may be found only among some members of the center groups, and even among these, reservations are numerous. The Economist, for example, points out that multilateral trade is desirable only if the British balance of payments problem can be solved without resort to bilateral arrangements, and expresses the opinion that, in the post-war period, a solution without bilateralism will be difficult if not impossible.[1]

While the political division between opponents and supporters of bilateral trade is somewhat indistinct, the latter may be divided with some precision, according to the reasons which they advance for their stand. Representatives of left-wing groups advocate controlled trade, first as a means of maintaining employment at home, and second, as a means of isolating both the United Kingdom and the rest of the Empire from what they fear will be a wildly fluctuating United States demand. In general, they regard close collaboration with the United States in post-war trade policies as a possibility only if an agreement can be reached to maintain and expand the level of world income. Business leaders, on the other hand, advocate bilateral measures primarily as means of securing balance between exports and imports. In other words, they are more concerned with immediate financial problems than with long-run repercussions upon employment and standards of living.

British periodicals and newspapers show that public opinion in the United Kingdom is much more favorably disposed toward bilateral agreements than is commonly believed in the United States. Indeed, there can be little doubt that popular support for controlled trade has increased considerably during the war. The United States cannot succeed in restoring free multilateral trade unless the British advocates of bilateral methods are convinced that their problems can be solved by non-discriminatory trade practices.

What does this mean for the United States? It means first that British left-wing and labor support for multilateral trade cannot be obtained unless the United States Government recognizes its responsibility for maintaining a high level of employment and income. The probable consequences of a post-war depression in the United States provide one of the most potent arguments against British abandonment of controlled trade. And those "to the left of center" in the United Kingdom are fully exploitingthis argument.

A second prerequisite to multilateral trade is reassurance to the British businessmen that the United States will not pursue an aggressive post-war export policy. Among other things, this means that we must not oppose currency depreciation on the part of countries with balance of payments deficits, that we must not subsidize exports, and that we must not use our tremendous lending power to drive British exports from world markets.

If the British are convinced that we intend to maintain a high level of income and that we will not pursue an aggressive export policy, the prospects for resumption of multilateral trade will be very much improved.

1/ The Economist January 29, 1944.

Sterilization of Foreign Exchange in Venezuela   Eduardo Montealegre

The extraordinary conditions resulting from the war have caused a very large inflow of gold and foreign exchange into the Latin American countries; their total international reserves have increased from less than 1 billion dollars before the outbreak of the war to over 3 billion dollars as of the present. This development has been the most important factor in bringing about the inflationary conditions which exist with more or less intensity in all these countries.

To protect domestic economies from the full impact of such external factors, several kinds of measures have been adopted: (1) revaluation of currencies; (2) introduction of differential rates for conversion of exports; (3) compulsory investments; (4) sales of gold to the public; (5) sales of central bank obligations and certificates of participation. While the first two are designed to reduce the creation of excess purchasing power in the hands of the local public, the last three measures are intended to mop it up after it has begun to circulate. Venezuela has combined both approaches in its attack upon the problem.

In order to sterilize foreign exchange surpluses amounting to a total for the last three years of about 86.0 million bolivares, the Central Bank of Venezuela has entered into an agreement with the petroleum companies whereby:

a) The Central Bank will acquire monthly from these companies an amount of dollars limited to the market demand for foreign exchange at the rate of Bs. 3.09 per dollar;

b) When that monthly amount is insufficient to meet the bolivar requirements of the companies, they will issue six months' obligations for sale to the public at 3 per cent per annum;

c) Sums required in excess of what can be secured by either of these methods may be secured by dollar sales to the Central Bank but at the gold import point of 3.01 bolivares rather than at the regular petroleum rate of Bs. 3.09.

The distinctive feature of this plan is the substitution of the petroleum companies for the Central Bank as the agency through which funds are withdrawn from the market. This is feasible in Venezuela where the petroleum companies enjoy high credit standing, and at the same time account for 83 per cent of the foreign exchange supply. Moreover, the Central Bank is relieved of the burden of interest charges which it would have to carry were it to issue its own obligations. Although the petroleum companies will have to bear the costs of the interest of their obligations or of the difference between the exchange rates, this will not be a net expense. Foreign exchange not sold to the Central Bank can be invested outside the country and may yield at a nearly equal rate. Furthermore, the differential rate against the foreign exchange proceeds of petroleum exports will operate only in case the companies fail to raise enough funds from the public. In this event they will pay a charge of less than 3 per cent and that only once. This is no real sacrifice weighed against the benefit to the petroleum companies of a policy of preventing a general appreciation of the bolivar in response to the limited demand for exchange.

The success of the plan itself depends upon the degree to which the public purchases the companies' debentures. This in turn will be influenced by the relation between the amount of borrowing requirements and the volume of funds seeking investment, the safety of the investment, and the rate of interest.

Bolivar requirements of the petroleum companies were inflated at the beginning of 1944 by extraordinary payments to the Government covering fees and back royalty payments under the 1943 Petroleum Law. But the normal monthly needs of the companies during the last part of 1944 were estimated at about 7.6 million dollars and the monthly average demand for foreign exchange at about 5.3 million dollars. In addition, it was estimated that large sums of domestic currency would be required upon the grant of pending applications for new exploration concessions. Altogether, the borrowing requirements of the petroleum companies in 1944 were supposed to have ranged between 86.0 and 148.0 million bolivares depending upon the extent to which exploration concessions were granted.

Although there is a considerable amount of funds seeking investment, and opportunities are at present relatively scarce, it is not possible to ascertain to what extent the public will buy the petroleum obligations. They may be considered safer than higher yielding Treasury notes and Government bonds, but a 3 per cent interest rate may fail to attract the large amounts needed. The usual yield of capital is very high in Venezuela. Of course, there would be no difficulty if the commercial banks were allowed to invest part of their excess reserves in these obligations. But since this would nullify the objectives of the plan and would be as inflationary as the conversion of exchange by the Central Bank, only individuals and other institutions are permitted to buy petroleum securities.