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May 9, 1950

Western Germany - Government Control of the Central Bank
By Gordon B. Grimwood 10 pages

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WESTERN GERMANY - GOVERNMENT
CONTROL OF THE CENTRAL BANK

Gordon B. Grimwood

With the exception of a decade between the two World Wars, the German central bank has been under government domination for almost two hundred years. The first central bank in Germany was the Koenigliche Bank, established as a State institution in Berlin in 1765 by King Frederick the Second of Prussia. This bank was replaced in 1846 by the Preussische Bank, which was owned by private shareholders but controlled by the State. By law of March 14, 1875, the Preussische Bank was transformed into the Reichsbank, which began operations as central bank of German Empire on January 1, 1876.

The Reichsbank was chartered under the Bank Act of 1875 with a capital at 120 million marks, the shares being owned by private individuals. The Government maintained control of the Reichsbank (1) through the Bank Curatorium, a supervisory body consisting of the Reich Chancellor as chairman and four members, of which one was appointed by the Emperor, and three by the Federal Council; (2) through the statutory provision that the Reich Chancellor would exercise "supreme direction" over the affairs of the Bank; and (3) through the power to appoint the members of the Board of Directors; this power was weakened, however, by the fact that all appointments to the Board were made for life. The Board was subordinate to the Reich Chancellor in his role as "supreme director".

The shareholders of the Bank were represented by a Central Committee of 15 members, who were elected at the annual meeting of the General Assembly of the shareholders. The Central Committee met once a month, in a purely advisory capacity; it also elected three delegates from among its numbers to meet with the Board of Directors in an advisory capacity. These delegates had voting power only under one circumstance; in cases involving transactions between the Reichsbank and the Reich or a Federal State, an objection to the action on the part of a Committee delegate could require a vote by the Central Committee, where a majority vote against the action could veto it.

The Reichsbank operated in this form until 1920, at which time it was rechartered with very few changes. An objection to Reichsbank policies on the part of the Reparations Commission resulted in the Autonomy Act of May 21, 1922, the main purpose of which was to free the Reichsbank from the supervision of the Government. This Act retained the Bank Curatorium and increased its members to nine, with the Chancellor as Chairman. The supervisory powers of this body were to be exercised in a

negative rather than a positive sense. In other words, its function was to prevent action considered injurious to the Government rather than to initiate action on behalf of the Government.

Through the revised appointive procedure under which nominations to the Board came from the Board itself, the Board of Directors became more autonomous, with the Government holding only the power of veto over such nominations. The President of the Board was appointed by the President of the Republic upon recommendation of the Federal Council, subject, however, to the approval of the Board of Directors. The power of the shareholders was strengthened by a provision that nominations to the Board of Directors had to be approved by the Central Committee.

The hyper-inflation of 1922-1923 led to the temporary suspension of the functions of the Reichsbank and the establishment of the Rentenbank and later the Gold Discount Bank, which exercised the power of note issue and credit control, respectively. Both of these banks were organized on the basis of no governmental control or supervision.

Initiated by the Dawes Committee and Dr. H. Jalmar Schacht, re-organization of the Reichsbank was accomplished by the Bank Law of August 30, 1924. This provided for the liquidation of the Rentenbank and the Gold Discount Bank and restored the Reichsbank to its position as the central institution for the issue of notes and the regulation of credit. Administrative power was vested in a Managing Board of Directors, whose members were appointed for terms of 12 years by the Reichsbank President after approval by the General Council. The Reichsbank President was elected by the General Council subject to the approval of the Reichs President. If, however, the Reichs President refused to sign the appointment of two successive selections of the General Council, the appointment resulting from a third election became legal and valid without the signature of the Reichs President. The term of the Reichsbank President was four years.

The General Council, which took the place of the old Bank Curatorium, was composed of seven German nationals and seven nationals of other countries represented on the Reparations Commission. The German members, one of whom was required to be the Reichsbank President, were elected by the shareholders of the Reichsbank, while the first foreign members were appointed by the Organization Committee of the Reparations Commission. After the initial organization, in the event of the withdrawal of a foreign member, the remaining foreign members of the Council would elect a new member from the country of the withdrawing member. In addition to the appointive duties outlined above, duties of the General Council were to re-

ceive reports from the Managing Board of Directors at monthly meetings, and to furnish one of their members (a foreigner) to control the issuance of currency as the Commissioner of Note Issue. The Reichsbank President acted as Chairman of the General Council.

The shareholders' position changed little under the new Bank Law. They were again permitted to elect a Central Committee, "whose consultative opinion the Managing Board may obtain, if they think fit". 1/ The Central Committee was empowered to elect Deputies for purposes of consultation in special matters; these Deputies might be invited to meet with the Managing Board of Directors for that purpose. In short, the only effective voice the shareholders obtained in the administration of the Reichsbank was their privilege of electing the German members of the General Council.

Article 25 of the Bank Law of 1924 limited the amount of credit which could be advanced to the Reich to 100 million marks, with a maximum maturity of three months on such loans. The Law further stipulated that the Reich could not be in debt to the Reichsbank at the close of any business year. Other than that, the Reichsbank was forbidden to grant, directly or indirectly, any credit to the Reich, States, municipalities, or foreign governments.

Under the terms of the Young Plan, the Bank Law of 1924 was amended on March 13, 1930, to provide for the withdrawal of the foreign members of the General Council. Under this amendment the General Council consisted of ten members, to be elected by members of the General Council in office as of that date, subject to the confirmation of the shareholders. This article providing for the General Council contained a significant addition: "Before the election the Chairman of the General Council or his Deputy shall consult the Government of the Reich concerning the election." 2/ No change was made in the composition or method of election of members of the Managing Board of Directors or the Central Committee.

The Bank Law of 1924 was further amended on October 28, 1933, to provide that the Reichsbank President should be appointed by the Reichs President "after the Managing Board of the Reichsbank have been given an opportunity of pronouncing thereon". 3/ The remaining members of the Board were to be appointed by the Reichs President upon proposal by the Reichsbank President. The General Council was completely eliminated.

1/ Bank Law of August 30, 1924, Article 13.

2/ Amendment to Bank Law of August 30, 1924m dated March 13, 1930

3/ Amendment to Bank Law dated October 28, 1933

The Deputies of the Central Committee were given the opportunity to pass upon reports concerning the note issue, to be submitted to them monthly by the Managing Board of Directors.

A law of December 5, 1934, effective January 1, 1935, created a Supervisory Board and a Banking Commission which placed the financial resources of Germany under the direction of the Reichsbank. By this time, the Managing Board of Directors was working in very close cooperation with the Reich government. The most important effect of the new law was to link together the extremely strict credit controls and the Reichsbank; Dr. Schacht, in addition to his duties as President of the Reichsbank, was appointed to lead the Supervisory Board established for the purpose of controlling credit.

The de facto control over the Reichsbank by the Reich, as exercised under the amended Bank Law of 1924, was made de jure on June 15, 1939, by the enactment of a "Law Concerning the German Reichsbank" which supplanted the Bank Law of 1924. The introductory paragraph of the new law stated unequivocally that "The German Reichsbank, as the German bank of issue, shall be subject to the unrestricted sovereignty of the Reich." The sections upon administration provided that "the Managing Board of Directors would direct and administer the Reichsbank in accordance with the Fuhrer and Chancellor of the Reich and under his supervision." ^{1/} The Fuhrer was given the power of appointing the President of the Reichsbank and the other members of the Managing Board, and to determine the duration of their terms of office.

Under the Law of June 15, 1939, shareholders were restricted to those persons "who, on the basis of their racial origin, fulfill the requirements for acquisition of citizenship". The Law provided for a general meeting of shareholders, but permitted the Central Committee to be eliminated by default.

By 1939, the Reichsbank was more completely under the domination of the Government than it had been at its inception in 1875 or anytime thereafter. The provisions of the Bank Law of 1924, the main purposes of which were to free the Bank from the supervision of the Government, had been abrogated.

Developments following the war

The German central banking system, consisting of the Reichsbank and its numerous branches, collapsed at the end of the war. When the

^{1/} Law concerning the German Reichsbank, June 13, 1939, Sec. 3

partition took place, all branches were cut off from the head office by zonal boundaries and thus were forced to operate with the assets at hand. Since there was a definite need for some type of financial system, the occupational authorities utilized the banking facilities already existing, with the Reichsbank branches in the three U. S. Zone Laender acting as central banks and agents of the Military Government.

Pursuant with that section of the Potsdam Agreement which called for the decentralization of the Germany economy, legislation was drawn up during 1946 for the purpose of establishing a central banking system on a Laender basis. The central bank legislation was passed in December 1946 and became effective in the three Laender of the U. S. Zone on January 1, 1947; one month later another central bank was added in the newly established Land Bremen.

Central bank legislation for the Land of Wuerttemberg-Baden, which is somewhat typical of the other Laender banks, provided that the Land Central Bank would be administered by a Board of Managers, the members of which were to be appointed for a term of five years. The President and Vice President of the Land Central Bank are appointed by the Land President upon recommendation of the Minister of Finance; other members are appointed by the Board of Directors upon recommendation of the President.

Management of the Land Central Bank is supervised by the Board of Directors consisting of nine members. The President of the board of directors is appointed from among the members by the Land President upon recommendation of the Minister of Finance; the President of the Land Central Bank serves as Vice President of the Board of Directors. Other members are appointed from the fields of agriculture, trade and industry, and labor by the Ministers having jurisdiction in these respective fields. In addition, shareholders of the Land Central Bank shall elect one representative from the private banking field, one from the credit cooperatives, and one from the credit institutions of public law.

An Advisory Council was established to act as coordinating agent among the three Land Central Banks. The charter of the Land Central Bank of Wuerttemberg-Baden provided that that Bank would be represented on this Council by the President of the Bank, the head of the Bank Supervisory Authority, and a member of the Board of Directors appointed by that Board.

Section 10 of the enabling legislation provided that the Land Central Bank is subject to State supervision, to be exercised by the Bank Supervisory Authority.

On March 1, 1947, Land Central Banks were established in the French Zone, and on April 1, 1948 in the British Zone. In September 1947 a central clearing office for the U. S. Zone Laender Central Banks was established in Frankfurt, which established correspondent relationship with the central banks in the other zone of occupation. None of the Land Central Banks were given the authority to issue currency.

Establishment of the Bank Deutscher Laender

During February 1948 there were promulgated simultaneously in the U. S. and U. K. Zones of Occupation military government laws which established the Bank Deutscher Laender, the laws to be effective March 1, 1948. This Bank was made the exclusive bank of issue in those zones and was limited to transactions with member Land Central Banks, central banks of other German Laender and of foreign countries or their equivalent, and the Bizonal Economic Administration. Land Central Banks in the French zone of occupation became members of the Bank Deutscher Laender when it was organized, thus providing a unified monetary policy for Western Germany a year in advance of the Trizonal economic fusion agreement of April 8, 1949.

A Board of Directors was established as the Bank's policy-making body, and a Board of Managers was created to execute these policies. The Board of Directors consists of a Chairman, elected by the members of the Board, the President of the Board of Managers, and the Presidents of each of the member Land Central Banks.

The President of the Board of Managers and his Deputy are elected, and their terms of office fixed, by the Board of Directors. The Chairman of the Board of Directors and the President of the Board of Managers, for this purpose, do not vote. Other members of the Board of Managers are then appointed by the full Board of Directors for such terms as may be determined by the Board of Directors. Terms of office of the members of the Board of Managers may be terminated, with cause, by the Board of Directors, and the President of the Board of Managers is responsible to the Board of Directors for carrying out all decisions of the Board of Directors and for the general conduct of the Bank.

In determining the policy of the Bank Deutscher Laender, the Board of Directors is subject to such directions as may be issued by the Allied Bank Commission, and shall submit to that Commission such reports and information as it may require.

In comparing this legislation with pre-war German central bank legislation, it will be noticed immediately that the supervisory body, the

Board of Directors, has more direct authority over the administrative body, the Board of Managers, than was true in typical pre-war legislation. The Bank Deutscher Laender is not, as was the Reichsbank, owned by private shareholders but by the Land Central Banks, whose stock is at present held by the Laender governments. Eventually, however, the stock is to be owned by the private credit institutions which are required by law to maintain minimum reserves with the Land Central Banks. At the level of the Bank Deutscher Laender, these institutions are represented only by their right to elect three members of the Board of Directors of the Land Central Banks.

The entire central bank system is closely connected with the financial policies of government through the connections of the Land Central Banks with the Laender governments. This control is exercised from the bottom up rather than from the top down, as had been the case with pre-war German central banking system. This control is due to the fact that the Land Central Bank Presidents constitute a majority of the Board of Directors of the Bank Deutscher Laender. The Bank Deutscher Laender serves as a coordinating agency in the fields of money and credit rather than as a controlling agency.

Proposed central bank legislation

On April 8, 1949, the Military Governors of the three Western zones of occupation issued the Occupation Statute, which stated that it was the intent of the occupation authorities to allow the German people to enjoy self-government to the maximum degree possible with the occupation. These authorities reserved full rights in certain matters, and also reserved the over-all right to pass upon any legislation enacted by a German government formed under the terms of the Occupation Statute. On May 23, 1949, the Basic Law for the Federal Republic of Germany was proclaimed. Article 88 of this law stated that "The Federation shall establish a bank of currency and issue as federal bank."

It has been generally agreed that the central banking system, established when the Bank Deutscher Laender was set up, is too decentralized to deal effectively with the present economic difficulties. Officials of the Allied High Commission and interested German authorities have been considering possible legislation to establish the federal bank provided for in the Basic Law in place of the Bank Deutscher Laender. Two drafts of legislation have been prepared, one by the West German government and one by the Bank Deutscher Laender as a counterproposal. With the exception of the ever-recurring problem involving the degree of government control to be exercised over the central bank, these drafts differ only in minor technical details.

Both drafts provide for an administrative organization practically identical to that of the present Bank Deutscher Laender; i. e., a policy-making Board of Directors, with a Board of Managers to execute the policy. The Board of Directors, as at present, shall be composed of a President, the President of the Board of Managers, and the Presidents of the Land Central Banks. Both drafts provide that the appointment of the President of the Board of Directors, who is to be elected by the Board, is subject to the confirmation of the Federal President. The organization of the Board of Managers and procedures of appointment are the same in both drafts, and conform closely to the procedure described for the Bank Deutscher Laender. Both drafts also provide that the Federal Government shall be authorized to delegate two members of the Federal Government to be named to the Board of Directors of the federal bank as non-voting members. These delegates would, however, have power to enter protests against decisions of the Board of Directors. Protested decisions would then be suspended, except in cases where changes in discount rate, interest rate on collateral loans, or changes in minimum reserve requirements were involved.

The so-called "Government draft" provides that such protests would be decided by a Federal Committee to consist of a Chairman to be nominated by the Federal President, five members of the Government to be appointed by the Government, and five members of the Board of Directors of the federal bank to be appointed by that Board, including the President of the Board of Directors and the President of the Board of Managers.

The "Bank draft" provides that, in case of a protest, the Federal Government would have the right to state its objection to the decision in writing and request that the Board of Directors make a second decision on the matter. This second decision would not be subject to protest by the Government.

Both drafts limit the amount of credit which may be advanced by the federal bank to the Government to one billion Deutsche marks; they further provide that this limit may be raised to DM 1.5 billion by a $\frac{3}{4}$ vote of the Board of Directors.

Both drafts provide that an Advisory Economic Council shall be established, the members (not to exceed 21) to be appointed by the President of the Board of Directors from various sectors of the economy. This Council is to be convened in an advisory capacity twice a year or whenever one-third of its members so request. This Council would bear approximately the same relationship to the new federal bank as does the Federal Advisory Council to the Federal Reserve System.

Conclusions

The Board of Directors of the Bank Deutscher Laender has objected strongly to the subordination of the Board of Directors of the new federal bank to the Government through the medium of the proposed Federal Committee. The Board bases its objection upon the grounds that such subordination would lead to a lack of public confidence in the bank of issue and possibly endanger the stability of the currency. Furthermore, the Board points out that in the past the central bank has always recognized the prime interest of the Government in the over-all economic situation, and that it would be very unlikely that the Board would go directly against the interests of the Government and the country as a whole in any matter of importance.

For purposes of comparing this legislation with pre-war German central banking legislation, it may be assumed that the influence of Federal Government will be predominant in the proposed Federal Committee. The "government draft", therefore, provides for much stricter governmental control than that provided for in the March 13, 1930, amendment to the Bank Law of 1924. Even under this amendment Hitler found little difficulty in subverting the functions of the Reichsbank to his own ends before he assumed official control of the Bank in 1939.

Consideration is being given at the present time to an agency to be established in the United States for the similar purpose of coordinating government and central bank policies. The report of the Sub-committee on Monetary, Credit, and Fiscal Policies submitted to the Joint Committee on the Economic Report of the U. S. Congress on January 13, 1950, recommended the establishment of a National Monetary and Credit Council composed of Government and Federal Reserve authorities. An important difference between the U. S. and German recommendations, however, is that the recommendation for the U. S. agency states that its purpose should be purely consultative and advisory and that it should have no directive powers over its members; while the recommendation for the German Federal Committee clearly assigns directive power to that body.

By virtue of the Occupation Statute, the Allied High Commission will have the final voice in any banking legislation enacted by the government of the Federal Republic of Germany. It is generally agreed that a close degree of coordination between the central bank and the government is necessary. However, in considering the questions of "coordination" or "control" in any proposed German central bank legislation, the High Commission should take into consideration central banking history in German.

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German Central Bank

Control of the central bank by the German government was an important factor in bringing the entire German economy under Government control in the interwar period and thus might have facilitated the Government's policy of aggression. In addition, Government control of the Reichsbank in 1920-1923 may well have prevented that institution from following a policy which might have avoided, or at least mitigated, the disastrous hyper-inflation of those years.

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ECA OFFSHORE PROCUREMENT*

Caroline Lichtenberg

In view of the interest in the distribution of U.S. foreign aid between "free" dollars and dollars tied to U.S. exports, it will be of value to see to what extent ECA dollars have been used to finance offshore procurement.^{1/} The purpose of encouraging purchases outside the United States during 1948 was to reduce to a minimum inflationary pressures on the U.S. economy. At the present time, however, interest in untied dollars is motivated mainly by the desire to stimulate multilateral payments. Nevertheless, ECA's experience with offshore procurement throws some light on the participating countries' demand for free dollars, on the commodities that were financed and on the extent to which non-participating countries have directly gained dollars from the European Recovery Program.

I. ECA Offshore Procurement Policy

It must be remembered that participating countries do not have complete freedom of choice in the use of their ECA allocations.^{2/} In addition to the general restrictions which apply to all ECA-financed transactions, a number of regulations applicable exclusively to offshore procurement have been designed to (1) implement provisions contained in ECA legislation and (2) ensure that offshore procurement properly contributes to European recovery. An application for offshore procurement must therefore meet the following general tests before ECA will issue the appropriate authorization:

- (A) That the specified commodity is eligible for offshore procurement,
- (B) That the source of supply is acceptable, and
- (C) That the proposed purchase price is reasonably competitive.

A. Commodities not eligible for procurement outside the United States

The surplus agricultural commodity provisions of the ECA Act (Sec. 112(d) (e) (f)) constitute the most important restrictions on offshore procurement. In general, they provide that, insofar as practicable and where it is considered that the purposes of the Act will be furthered, the Administrator shall authorize the procurement in the United States of any agricultural commodities which have been declared surplus to U.S. domestic needs by the Secretary of Agriculture. Authorizations for offshore procurement of food and agricultural commodities, therefore, have been

* The main content of this paper was originally prepared for the use of ECA.

^{1/} Offshore procurement, as used throughout the text and in the tables, refers to authorizations for procurement outside the United States. Because of the time lag between the issuance of procurement authorizations and actual shipments, the use of the former permits a more up-to-date picture of ECA operations.

^{2/} See Liberalization of the ECA Dollar in this Review, January 3, 1950.

limited to items (1) not produced in the United States or (2) not available in sufficient quantities to satisfy domestic requirements as well as all demands on such supply for export. Since April 3, 1948, when ECA began operations, the Secretary of Agriculture has declared many commodities requested by participating countries to be in surplus and available in quantities sufficient to meet all the then existing requirements of the participating countries. Among the most important commodities which have been declared in surplus are wheat, cotton, tobacco, cheese, bacon, coarse grains, fats and oils, and oilcake and meal.

B. Regulations on sources of supply

1. Necessity for use of dollars.- It must be shown that the purchasing country cannot supply an acceptable currency other than the dollar.

2. Participating countries.- Since the introduction of the Intra-European Payments Plan in October 1948, it has been the policy of ECA not to finance directly purchases made by one participating country in another participating country or in the independent sterling area. Reliance has been placed on the Payments Plan to cover the major part of intra-European deficits.

a. Belgium.- Under the 1949/50 Intra-European Payments Agreement, special arrangements proved necessary in the case of Belgium. Last summer, it was estimated that Belgium's surplus with the participating countries would exceed its estimated dollar deficit during the current fiscal year. The estimates on which the arrangements were based were a dollar deficit of \$200 million and a European surplus of \$400 million. In order to reduce the ECA dollar aid necessary to cover the Belgian intra-European surplus, it was agreed that Belgium would finance a part of its surplus (\$87.5 million) by the extension of long-term credits to the United Kingdom, France, and the Netherlands. In return ECA agreed that offshore purchases in Belgium by participating countries of certain essential commodities would be considered eligible for direct ECA financing up to the total of \$112.5 million. This amount represents the difference between the estimated surplus with the participating countries and the Western Hemisphere deficit after making allowance for the amount extended by Belgium in the form of credit. In view of the reduction of the Belgian surplus position in Europe since the currency revaluations, it is doubtful whether this offshore provision will become very important.

b. Switzerland.- Switzerland is the only member country of the OEEC which is not a full participant in the Intra-European Payments Plan. It is eligible, therefore, for offshore purchases by the participating countries on the same terms as other nonparticipating countries. Requests for offshore procurement in Switzerland are considered favorably by ECA if they meet the general criteria of essentiality, competitive pricing and lack of other acceptable means of payment.

c. Sale of dollar raw materials refined and processed in participating countries.- Prior to the inception of the Intra-European Payments Plan, it was the practice of some countries now participating in the Plan to invoice the sale of certain commodities to other participants in dollars. This was the case particularly where dollar raw materials were processed in a participating country prior to sale as a finished product. In many cases such processing or refining was performed as an in-bond transaction. Examples of such processing are petroleum, nickel, copper refining, and automobile assembly. As a result of such dollar invoicing, the burden of the dollar outlay for the raw materials was shifted from the processing to the consuming country.

With the inception of the European Recovery Program the justification for this practice has largely been eliminated, since it is possible for ECA to take account of these dollar import requirements in determining the aid allotments of the participating countries. Consequently, since June 20, 1949, ECA has not financed the sale of a refined or processed product to another participant for dollars. The dollar cost of the raw materials and necessary supplies has been financed by ECA from the allotment of the country where the processing operation took place, and the latter is expected to sell the refined product for its own currency within the framework of the Intra-European Payments Plan. ECA does make exceptions, however, in those cases where it can be shown that the application of this policy would cause a hardship to the processing country and interfere with the flow of intra-European trade.

3. Petroleum and petroleum products.- While ECA finances offshore purchases of petroleum and, indeed, urged offshore procurement during the first year of the program, the offshore source must be, directly or indirectly, an American-owned and operated company. To make sure that no non-dollar oil is financed by ECA, a special statement showing the relation between the imported materials and the supplier must accompany standard ECA documentation in cases where American participation is indirect. There are several types of arrangements whereby participating countries buy dollar oil indirectly through non-dollar firms:

(1) Where stock ownership in the exporting company is predominantly foreign or where American ownership is on a participating basis: In such cases, only the fraction of the total purchases corresponding to the American share in the ownership will be financed with ECA funds.

(2) Where petroleum products, purchased by participating countries directly from non-dollar processing companies for dollars, have been derived from dollar crude oil and processed under a processing agreement between the dollar oil company and the non-dollar processing firm.

(3) Where, as the result of an exchange agreement, a dollar oil company ships non-dollar oil borrowed from a foreign firm with the stipulation that the loan will be repaid with dollar oil.

(4) Finally, ECA will finance participating countries' dollar purchases of oil from dollar sources if the oil, originally bought from non-dollar companies, was paid for in dollars by the supplier.

C. Price regulations

The principal price requirements are the following:

1. That the offshore country offers terms at least as favorable as those offered by a U.S. supplier.
2. That the offshore purchase price for bulk commodities does not exceed the prevailing price in the United States adjusted for difference in the cost of transportation to destination, quality and terms of payment.
3. That the offshore price is not higher than the prevailing export price.
4. That the offshore price does not exceed the suppliers local domestic market price adjusted by customary and reasonable export differentials.

To ensure compliance with the price regulations, ECA makes a post-examination of offshore purchases. If the purchase price is found to exceed the limits of test (2) above, ECA will hold the transaction ineligible for payment and will demand repayment of the entire purchase price by the participating country. If the purchase price is found to be within the limits of (2) but excessive in terms of (3) and (4), ECA may limit its demand for repayment to the amount of such excess.

The volume of offshore procurement was probably reduced by the provision that the official exchange rate had to be applied to the supplier's price while the supplier's currency could often be purchased at a discount for free dollars. This application of the official exchange rate resulted in making some non-U.S. products more expensive than the corresponding American products and therefore ruled out offshore procurement which might have taken place under freer trading conditions.

II. Survey of Operations

A. April 3, 1948 through March 31, 1950

From the beginning of the program in April 1948 and cumulative through March 31, 1950, authorizations for procurement offshore amounted to about \$2.5 billion or almost one-third of total authorizations issued as indicated in Table I. However, in terms of the nationality of the supplier rather than the geographic area of origin, procurement from non-American sources amounted to less than 25 per cent of the total.^{1/}

^{1/} This figure was calculated by including all offshore procurement of petroleum and products in the U.S. total rather than in the figure for offshore procurement. Other commodities procured offshore are also purchased from American companies abroad so that the proportion of procurement from non-American sources is even less than indicated here.

Table I. Distribution of Authorizations
for Procurement by Area of Origin*

Area of Origin	P e r i o d					
	April 3, 1948- March 31, 1950		April 3, 1948- March 31, 1949		April 1, 1949- March 31, 1950	
	Millions of dollars	Per cent of total	Millions of dollars	Per cent of total	Millions of dollars	Per cent of total
All areas	8,062.9	100.0	4,358.9	100.0	3,704.0	100.0
United States	5,567.8	69.1	2,821.3	64.7	2,746.5	74.1
Offshore	2,495.1	30.9	1,537.6	35.3	957.5	25.9
Canada	1,084.1	13.4	698.9	16.0	385.2	10.4
Latin America	620.7	7.7	355.3	8.2	265.4	7.2
Participating countries	386.3	4.8	275.0	6.3	a/ 111.3	3.0
Other countries	404.0	5.0	208.3	4.8	195.7	5.3

* Totals may not add because of rounding.

a/ Over 90 per cent of this amount was for procurement of dollar oil from American companies located in territories of the participating countries.

1. Principal suppliers.- Canada was the largest single supplier outside the United States, accounting for \$1.1 billion or 13 per cent of total authorizations and 43 per cent of those issued for procurement offshore. The chief commodities obtained by the participating countries, and particularly by the United Kingdom, were breadgrains, non-ferrous metals and pulp and paper. The Latin American countries as a group ranked second in importance with \$620 million or 8 per cent of total authorizations. One-quarter of the authorizations issued were for procurement offshore; the principal items supplied were petroleum, sugar and non-ferrous metals.

Procurement in non-participating countries outside the Western Hemisphere accounted for 5 per cent of total and 16 per cent of offshore. Most of the authorizations represented oil purchases in the Middle East. Fabricated basic textiles and some non-ferrous metals were imported from Japan, and copra and certain fibers were obtained from the Philippines. Procurement in Eastern Europe was limited to purchases of coal, fertilizer, soft-wood and lead.

2. Commodity distribution.- Almost all of the authorizations for offshore procurement were for commodities which were either not produced in the United States or were not available here in sufficient quantities to satisfy external demand. These items were almost exclusively foodstuffs and raw materials. Breadgrains and petroleum together accounted for a little more than 40 per cent; authorizations for sugar and non-ferrous metals for another 25 per cent. With respect to a number of the commodities procured offshore, non-U.S. sources represented the major sources of supply. Thus over 90 per cent of ECA-financed sugar imports were scheduled for procurement in Latin America; 75 per cent of both non-ferrous metals and pulp and paper were bought in Canada and Latin America; and over two-thirds of the authorizations for petroleum and for hides and skins specified suppliers outside the United States.

B. Developments during 1949

There was a marked change in the distribution of authorizations between the United States and other countries during 1949 compared with 1948^{1/} (see Table I). In 1948 authorizations for procurement offshore represented 35 per cent of the total, while in 1949 they accounted for only 26 per cent.

1. Enforcement of surplus agricultural commodities provisions.- It is clear from Table II that the decline in grain exports, which amounted to over 40 per cent of the 1948 level, was the most important single factor in the falling off of offshore procurement. This was primarily the result of ECA's application of the surplus agricultural commodities provisions in January 1949 and, to some extent, was due to the general decrease in European demand for breadgrains. Except for wheat procured under a special U.S.-Canada-U.K. agreement, participating countries have procured no breadgrains outside the United States since January 1949.

In order to prevent a worsening of the financial crisis which preceded devaluation and to enable the United Kingdom to meet its contract commitments with Canada ^{2/}, ECA made an exception in the case of the United Kingdom in the summer of 1949. ECA agreed to finance \$175 million worth of Canadian wheat exports in spite of the fact that U.S. wheat was then in surplus. In return for this concession, the United Kingdom agreed to buy an additional \$30 million worth of U.S. wheat and \$8 to \$10 million of perishable surplus agricultural commodities which it had not previously scheduled. Canada, in turn, agreed to remove all restrictions on the importation into Canada of American fresh fruits and vegetables.

^{1/} Throughout the following discussion 1949 refers to the period April 1, 1949 through March 31, 1950 and 1948 refers to the period April 3, 1948-March 31, 1949.

^{2/} The contract, which had been made two years prior to the European Recovery Program, provided that the United Kingdom would purchase about \$300 million worth of Canadian wheat over a four-year period.

Table II. Major Commodities Procured Offshore

Commodity	P e r i o d					
	April 3, 1948- March 31, 1950		April 3, 1948- March 31, 1949		April 1, 1949- March 31, 1950	
	Millions of dollars	Per cent of total	Millions of dollars	Per cent of total	Millions of dollars	Per cent of total
Total - All commodities	2,495.1	100.0	1,537.6	100.0	957.5	100.0
Petroleum and products	591.2	23.7	299.4	19.5	291.8	30.5
Breadgrains	455.7	18.3	315.9	20.5	139.8	14.6
Non-ferrous metals and products	389.3	15.6	233.2	15.2	156.1	16.3
Sugar and related products	229.2	9.2	112.9	7.3	116.3	12.1
Coal and related fuels	96.9	3.9	86.2	5.6	10.7	1.1
Pulp and paper	72.9	2.9	44.7	2.9	28.2	2.9
Fats and oils	67.7	2.7	71.1	4.6	-3.4	-0.4
Hides and skins	49.5	2.0	33.0	2.1	16.5	1.7
Fabricated basic textiles	48.8	2.0	30.2	2.0	18.6	1.9
Lumber and lumber manufactures	55.3	2.2	35.9	2.3	19.4	2.0
Feed and fertilizer	48.7	2.0	42.5	2.8	6.2	0.6
All other	389.9	15.5	232.6	15.2	157.3	16.7

2. Intra-European Payments Plan.- The introduction of the Intra-European Payments Plan, which eliminated ECA financing of intra-European transactions, was another important factor contributing to the decline of offshore procurement. Authorizations for coal and related fuels declined by \$76 million; for fats and oils by \$75 million and for feed and fertilizer by \$36 million. A large part of these items was purchased during 1948 in participating countries. Procurement of fats and oils from non-U.S. sources also declined as a result of the surplus commodities provisions.

III. Conclusion

In spite of the restrictions on offshore procurement, non-participating countries have directly benefitted from the European Recovery Program to the extent of \$2.5 billion. These additional dollar earnings enabled several of the non-participating countries to increase their dollar reserves. For example, Canada added \$363 million to its dollar balances during the period March 1948-March 1949, or slightly more than half of ECA authorizations for procurement which amounted to about \$700 million. Between the end

of March 1949 and March 31, 1950, however, when authorizations had been pared down to \$385 million, dollar balances actually declined by about \$14 million. Thus offshore procurement has been an important factor in Canada's dollar position.

Chile's total gold and dollar balances also increased from \$89 million at the end of March 1948 to \$96 million at the end of March 1949 and between March 1949 and March 1950 there was an increase of \$14 million. Venezuela, which supplied participating countries with large quantities of petroleum, increased its gold and dollar reserves by over 40 per cent (from \$306 million to \$436 million) between March 31, 1948 and the end of March 1949, and there was also a substantial increase (from \$436 million to \$483 million) during the period March 31, 1949 through the end of March 1950. Other Latin American countries, although not able to improve their reserve positions, found that ECA dollars were instrumental in cushioning the effects of the decline in demand for some of their principal export items.

The availability of free dollars to participating countries did not, in general, put U.S. suppliers to the test of competition. Many of the products which non-participating countries could probably offer most successfully at competitive prices are precisely the items which are not eligible for offshore procurement, viz. food and agricultural commodities.^{1/} On the other hand, while ECA dollars can be freely used for offshore procurement of manufactured goods and capital equipment, there are virtually no offshore suppliers of such commodities outside the participating countries.

It can be expected that offshore procurement will decline since imports from the United States are not likely to be reduced at the same rate as ECA aid. Participating countries will probably find that a higher proportion of the appropriation will be needed to cover essential imports from the United States. On the other hand, new elements of flexibility in the use of ECA dollars are to be introduced during the coming year. First, participating countries will, in general, be able to accumulate dollar reserves without fear of reduction in their subsequent ECA allotments. Second, \$600 million is expected to be contributed to a European Payments Union which will then open the way for expansion of multilateral settlements. These dollars, together with say \$600 million diverted to third countries via offshore procurement, will make ECA's free dollar outlays equivalent to about one-third of total ECA aid.

^{1/} One important exception to this is lumber, which participating countries may and do buy offshore even though U.S. exporters have ample supplies. As a result of complaints by U.S. exporters, ECA is now requiring additional documentation from participating countries who are parties to such transactions.