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REVIEW OF FOREIGN DEVELOPMENTS

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INTRA-EUROPEAN FINANCIAL ARRANGEMENTS

J. Burke Knapp

The New York Times for July 10 published a dispatch from Geneva reporting that the countries of the Benelux Union were expected to propose the establishment of "a clearing house for Europe in which net trade balances of European countries would be settled in dollars furnished by the United States." This proposal was reportedly conceived "as an addition to Anglo-French plans for implementing the Marshall plan".

There follow some tentative notes which had been prepared on this general subject and which may prove useful in assessing any detailed proposals along this line which may emerge from the European Economic Conference at Paris.

The first condition of an expansion of intra-European trade is the growth of production in European countries to a point where exportable surpluses are developed. But even after surpluses over essential domestic requirements appear, these are likely to be exported only where there is an immediate prospect of compensating imports. That is, exporting countries expect to be paid by importing countries in goods or in currencies which can be used to procure goods elsewhere. European countries are not interested in exporting for the sake of stimulating domestic income and employment or (in general) for the sake merely of maintaining markets.

Under these circumstances it was natural that after the liberation a large part of intra-European trade proceeded within the framework of bilateral clearing and payments agreements. There is little doubt that in the period following the end of hostilities bilateral trade and payments arrangements provided the most promising and in fact the only available method for quick resumption of the flow of goods among European countries. In view of the general disruption of trade channels, attempts at an immediate reconstruction of the network of multilateral trade in Europe could hardly have succeeded. Nevertheless, the beneficial effects of the bilateral agreements are rapidly receding into the background before the detrimental effects of bilateralism in trade.

Once the volume of trade has exceeded a certain minimum, continued matching of exports and imports on a bilateral basis becomes an increasingly arduous task. While country A may be greatly interested in an increasing flow of imports from B, the latter may find little that it needs to import from A. Very often in this process attempts at bilateral balancing of exports and imports fail. Then either trade does not grow at all or clearing balances develop which represent involuntary loans from the export surplus to the import surplus country and which must be dealt with if trade is to continue on the expanded basis. The task therefore is to liberate Europe's internal trade from the requirement of bilateral balancing.

This can be accomplished only if any net balance in the bilateral trade of two given European countries can be settled:

- (a) by the net importing country paying for the difference in U.S. dollars, gold, or a currency freely convertible into dollars; or
- (b) by the net importing country paying for the difference in a currency which, while inconvertible, can nonetheless be used in the course of triangular or multiangular settlements; or
- (c) by the net exporting country granting credit to the net importing country, e.g., by accepting and agreeing to hold the currency of the net importing country; or
- (d) by the establishment of some multilateral clearing system for Europe combining the functions of multiangular settlement and the extension of credits within the group.

To the extent that none of the foregoing conditions are satisfied, a country which might have provided exports to its trading partners in Europe if goods flowed independently of payment problems, will in fact reduce its exports to the level which can be accommodated by payment possibilities. This tendency toward reduction to the least common denominator obviously militates against the free interchange of supplies in Europe and the maximum degree of self-help from European resources.

It should be made clear that the provision of adequate financial mechanisms will not of itself assure that trade will flow. The arbitrary imposition of export (and import) controls might destroy trading opportunities created by financial arrangements. But it remains a necessary condition of the expansion of intra-European trade that some way or ways be found to accomplish the settlement of net bilateral balances. How then may conditions (a), (b), (c), and (d) above be more effectively achieved?

(a) The acute demand in Continental Europe for extra-European imports, which in general must be paid for in dollars or in media of exchange convertible into dollars (i.e., gold, Swiss francs, and pounds sterling), has created an acute demand for such currencies. It should be emphasized that this demand now extends to pounds sterling since from July 15 foreign acquisitions of pounds on current account will be freely transferable (in effect, freely convertible into dollars); pounds will therefore be just as "hard" a currency as dollars, except, of course, for the frozen portion of accumulated sterling balances which will become entirely unavailable for current transactions. Meanwhile, the British, because of convertibility demands upon them plus their own urgent need for dollar imports from the Western Hemisphere, must seek every opportunity to obtain dollars. Hence sterling is universally acceptable as a means of payment on the Continent, and dollars throughout Europe including the United Kingdom. It would be possible, therefore, to develop a freely-functioning payments system in Europe based upon the direct use of sterling or dollars to the extent that countries having bilateral deficits to meet were supplied with these currencies.

Indeed the British are consciously striving to establish the pound sterling as the medium for multilateral settlements in Continental Europe. In a series of recent payments agreements negotiated by the British to implement their obligation to make sterling convertible for current transactions as from July 15, a wide number of European countries have already undertaken to accept payment for their exports in pounds sterling not only from countries in the sterling area, but also from all other countries with which the United Kingdom has negotiated such payments agreements. The British are seeking to widen this circle of agreements to include all European countries as well as many outside. The British stand to benefit to the extent that the pound sterling becomes the medium for multilateral settlement among other countries for the reason that (1) this leads foreign countries to hold working balances in London (this amounts to a loan to the United Kingdom, incidentally on very advantageous terms), and (2) it leads countries to employ British financial services (banking, insurance, etc.). The same kind of clearing system could of course be built up with the use of dollars as the medium of exchange, but in view of the United States interest in bolstering the British position, we should presumably be sympathetic with their efforts.

Obviously, however, it is not necessary to rely upon the use of a hard currency for multilateral settlements of bilateral balances within Europe if in the end the network of bilateral balances fully cancel out. In such case, the hard currency becomes merely a token which is passed around the circle, ending up where it started. The same result might have been achieved by a central clearing (offsetting) of claims among the countries concerned. The use of hard currency for settlement of bilateral balances

becomes important only when some individual countries make net payments (and others receive net payments) in the course of such settlement. But when net payments appear, the need for external assistance may also be expected to arise since few European countries can afford to make such payments on any substantial scale from their existing limited hard currency reserves. At this point, the sterling system breaks down since the United Kingdom in turn cannot afford to lend sterling to foreign countries, thereby increasing the strain on its dollar reserves. Only the United States is in a position to provide the assistance necessary to make a hard currency payments system workable.

How then might this United States assistance be provided? Conceivably the United States might undertake to underwrite any bilateral balance between any two European countries by making a dollar loan to the net debtor to cover the settlement. But this would represent an extravagant use of dollars for the limited purpose of developing intra-European trade. Clearly it would be preferable from the point of view of the United States to see procedures established under which (1) bilateral balances were cleared (offset) within Europe so far as possible, (2) remaining net balances were carried so far as possible by the creditor countries without resort to the United States, and (3) the United States financial contribution to the promotion of intra-European trade was limited to providing means for settling burdensome net balances which were inhibiting maximum self-help from European resources. Possible procedures of this character are considered in the following paragraphs.

(b) The first step directed toward elimination of bilateral restrictions on trade might therefore be promotion of triangular or multi-angular settlements of bilateral balances, which can be carried out whether the currencies involved are freely convertible or not. For example, a country (A) which is a net importer in its bilateral trade relations with B may make payment in the inconvertible currency of a third country (C) which happens to be usable by B for payments to C; or A may be able to pay B in A's inconvertible currency provided that B can use it for payments to another third country (D) which can in turn employ it for payments to A; other more or less intricate settlement possibilities may be conceived. The greater the number of countries that are brought into such a clearing system, the more likely it is that possibilities for offset operations will be found. Unfortunately, however, the success of such a system can be thwarted through various resistances appearing at one or another point of the circuit. Countries may hesitate to acquiesce in the settlement process because they may think themselves, rightly or wrongly, in a position to collect debts owing them while avoiding or postponing debts owed. Lack of cooperation on the part of one important trading country may jeopardize the settlement of balances for several countries. To break through such resistances may require an agreement among a significantly large group of European countries committing them to carry out such offsetting arrangements to the maximum extent, perhaps under the coordination of some central agency.

If the process of multiangular balancing were to be fully carried out, the still uncleared balances would represent simply the net balances of each participating country in its total intra-European trade.

(c) A further opportunity for developing financial self-help by European nations lies in the direction of expanding their mutual interchange of lines of credit in the form of commitments to accept and hold each others' currencies as a temporary form of settlement. Such arrangements are at present the basis for a large number of intra-European payments agreements. But most of these agreements have been entered into reluctantly and for quite moderate amounts. Again it is repeated that European countries have little if any interest in promoting exports for exports' sake. The extent to which this form of agreement can be developed is seriously limited by the fact that most European countries must obtain compensating imports so far as possible for their exports. If a particular country is unable to offer compensating imports (or currencies which can be used to procure such imports) other countries are naturally inclined to divert their exports elsewhere rather than to export on credit terms.

If such credits were rather generally extended and expanded, however, many more opportunities probably would develop for triangular and multiangular settlements of accumulated balances along the lines of (b) above. The development of such settlements would in turn encourage the extension of new credits. In particular it should be noted that intra-European trade could be much more readily expanded in this manner than by the negotiation of inflexible and detailed barter deals in specific commodities.

Definite encouragement would be given to the development of a pattern of credits along these lines if the United States should undertake to make loans to debtors for the purpose of repaying "intractable" balances accumulated under such agreements, i.e., balances which the creditor country found impossible to liquidate within a reasonable time through purchases in the debtor country or through transfer to third countries. The creditor country might be required to guarantee the debtor's obligation to the United States (at least as to principal), although to the extent that creditors were required to underwrite such obligations they would be less prepared to let the credits accumulate in the first instance. If the creditor were to be freed of obligation, it might be necessary for the United States to stipulate that it would make loans to repay clearing balances only if they had arisen from a constructive flow of essential goods; otherwise, creditor countries might artificially expand shipments of non-essential goods on credit terms in order eventually to realize dollars from them. Probably a further condition of any United States aid in mobilizing intractable balances should be that the creditor country has genuine need for dollars in meeting its balance of payments; Switzerland, for example, might be prevailed upon to accept some such balances, without underwriting by the United States, as a contribution to general European reconstruction.

(d) Solutions (b) and (c), useful as they might be, are inherently cumbersome because of the bilateral character of the underlying transactions. This may lead to more ambitious suggestions for some form of central multi-lateral clearing among European countries.<sup>1/</sup> This might take the form of a commitment on the part of each country to accept in payment for its exports a given global amount of the currencies of other participants in the program.

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<sup>1/</sup> Indeed this seems to be the direction of the reported proposals by the Benelux Union.

An alternative method, which mechanically would be simpler, would be for each country to contribute a given quota of its own currency to a common pool under the administration of a central European financial agency. Each member could then use its own currency to purchase from the pool the currencies which it required to make settlements on current trade within the group. The analogy with operations of the International Monetary Fund is apparent--the initial currency contributions might be made proportionate to, although presumably smaller than, the Fund quotas of the participants. It is suggested, however, that in this case the central pool be utilized only to finance trade among the members which they find by common agreement to represent a constructive flow of essential goods. In this case, there need be no quantitative limitations upon the amounts which member countries could draw from the pool.

To a considerable extent, such a system would marry the operations described in (b) and (c) above and put them on a multilateral basis under the management of a central financial agency. So far as essential current trade was concerned, there would be an automatic clearing of offsetting triangular and multiangular obligations; each country's net position vis-a-vis the aggregate of the other members would be reflected in the net increase or decrease of the holdings of its currency by the central pool. It would remain for the central agency to facilitate ad hoc arrangements for the triangular or multiangular offsetting of pre-existing currency holdings or other obligations among the participants, including balances arising out of non-essential trade.

Under a general agreed directive, the central agency might assume responsibility for determining in detail what transactions could be financed by member countries through the pool--i.e., whether proposed expenditures were for constructive imports of essential goods. Furthermore, with the granting of credits now removed from bilateral channels, the central agency might undertake to allocate available credit among competing demands. If the currency of A tended to be drawn out of the pool in payment for A's net exports to the rest of the group, the central agency might be authorized to ration it to prospective purchasers in accordance with the "essentiality" of their needs for it. Or as A's currency became scarce in the pool, the central agency might be able to use some of its currencies in excessive supply to purchase supplies of A's currency held by third countries; these might be countries outside the pool, or countries in the pool which had held A's currency before the pool was launched or had accumulated it in transactions outside the pool (non-essential trade, capital movements, etc.). As a last resort, the central agency might ask A to supply further amounts, either as a further credit contribution or in exchange for dollars.

The requisite dollars might be supplied to the pool:

(a) through having countries whose currencies had accumulated in the pool in excessive amounts repurchase such excess holdings against dollars, possibly dollars loaned by the United States to such countries; or

(b) through United States loans directly to the pool, secured by the pledge of its currency holdings and/or by a collective guarantee from the members of the pool on some pro rata basis. Since the pool's currency holdings would tend to become exclusively those of the debtor countries, a collective guarantee would be necessary if the creditor countries in the pool were to share in the obligation to the United States. Such sharing would not be necessary to avoid abuse of the proposed system (cf. p. 5 above) since the system would still be desirable in some degree in recognition of the common European interest in promoting general recovery through a growth of intra-European trade.

Consideration would have to be given to the relations of such a central financial agency for Europe to the International Monetary Fund. While its operations would be patterned in part upon those of the Fund, and might prove of considerable significance to the Fund, it is clear that its specialized functions could hardly be discharged by the Fund or a European subsidiary thereof. Nonetheless, the agency would have operations and objectives thoroughly consistent with the Fund's aims, and would presumably enter into a close consultative relationship with the Fund.

FOREIGN GOLD AND DOLLAR RESOURCES

Florence Jaffy and Frank M. Tamagna.

Growing interest in the foreign dollar problem has led to the recent appearance of several published estimates of foreign gold and dollar resources. Two of these are discussed below. Herbert Hoover, in a letter to Senator Styles Bridges released on June 16, gives figures on existing foreign balances and unexpended amounts of U.S. government credits and gifts, and makes broad reference to other potential foreign dollar resources, including the extension of private loans and gifts and the use of the facilities of the International Fund and Bank. The National City Bank of New York, in its monthly letter for July 1947, supplies figures on foreign dollar balances and gold reserves, and gives details of the potential supply of dollars from various sources under existing credit or relief programs.

This note will deal in general with U.S. government lending and relief, and in particular with gold and dollar balances. It will not be concerned with private loans or gifts. There is no serious discrepancy in the figures of gold and dollar balances and other dollar funds available to foreign countries, as presented by these sources. Nor are the figures seriously out of line with data and estimates compiled at the Federal Reserve Board. However, in some cases, comment seems called for on interpretations and conclusions which are drawn, either explicitly or implicitly, from the statistical material.

Loans, Credits, and Gifts

The Hoover letter indicates that, as of July 1, 1947, over \$5 billion of "unexpended balances on appropriations and various credit commitments" are potentially available to foreign countries. This does not include amounts which may be drawn from the International Bank or Fund. The National City Bank's comparable figure is \$6 billion, of which \$4 billion represents U.S. government lending, and \$2 billion U.S. government relief and special aid.

Mr. Hoover does not offer a breakdown for his estimate. The National City Bank includes in its figure of \$4 billion of U.S. government lending the following items: Export-Import Bank loans, lend-lease pipeline credits, surplus property credits, ship sales, loan to the United Kingdom, and U.S. stabilization fund credit. Included in the \$2 billion of government relief and special aid are UNRRA, post-UNRRA relief, relief in occupied areas, Greek-Turkish aid, Philippine aid, and the IRO. Assuming that the Hoover figure excludes, and the National City Bank figure includes, uncommitted lending authority of the Export-Import Bank, the two figures seem in substantial agreement. The figure of \$6 billion seems in fairly close accordance with estimates prepared in the Federal Reserve Board for the end of June 1947.

While Mr. Hoover gives no estimate of dollars that may become available through the International Fund or Bank, the National City Bank adds to its tabulation of "potential" dollar resources the amounts of \$3.2 billion for the Bank and \$3.4 billion for the Fund. The figures may be misleading unless it is understood that the International Bank has, and can lend out of its own capital, only about \$725 million in dollars (representing the 20 per cent U.S. paid-in subscription plus dollar contributions by other countries on the basis of 2 per cent of their own subscriptions), but additional dollar funds are to be raised by the sale of debentures in the U.S. market. The National City Bank's figure of \$3.3 billion presumably represents its estimate of the minimum amount of debentures which will be sold, plus the amount available to the Bank from the dollar portion of its capital.

On these bases, the aggregate estimate of the National City Bank of roundly \$12.7 billion would seem to represent fairly accurately the sum of dollars potentially available to foreign countries from U.S. government lending and relief, plus the International Fund and Bank.

Neither the National City Bank total nor the smaller Hoover figure can be taken in any sense as being available on demand; in fact, the former will not be disbursed in the coming year, but only over a number of years. There are both practical and legal limitations upon the rate at which these funds can be drawn on and the purposes for which they may be used.

Gold and Dollar Balances

Mr. Hoover makes reference to \$14 billion of "foreign deposits in American banks, including earmarked gold and foreign ownership of American securities". In giving this figure, he stresses it as an indication of the size of U.S. liabilities to foreigners, rather than the extent of the dollar

assets of foreign countries. Whether or not the inclusion of earmarked gold is legitimate (in view of the fact that earmarked gold is not part of the U.S. monetary stock, and title to it is retained by the foreign countries) is beside the present point. The figure appears high for the present date in comparison with estimates prepared in the Federal Reserve Board in which the sum of these three items totals less than \$13 billion, including gold earmarked for the International Fund.

The National City Bank's figures of over \$5 billion for dollar balances and \$15 billion for total foreign gold reserves (in this country or elsewhere) as of May 31, 1947, appears substantially correct (if "dollars" means both private and official balances, and if neither gold nor dollars held by international institutions are included). The total gold and dollar figure may be closer to \$19 billion at the end of June. The National City Bank estimates new gold production at \$700 million annually, which appears reasonable, if both the U.S. and U.S.S.R. production are excluded.

The National City Bank, with some qualifications, places emphasis on the "unprecedentedly high level" and "staggering magnitude" of these balances, indicating by means of a diagram (no figures are given) the increase in balances since 1936. It seems desirable to point out, in greater detail than given by the National City Bank, certain circumstances which should be taken into account in judging the significance of these figures:

1. The absolute amount of foreign gold and dollar reserves does not indicate how much foreign countries are free to use for financing balance of payments deficits:

(a) Of the \$5 billion of dollar balances, over half are held privately, and their use depends on the degree of control which foreign governments may exercise or the willingness of private holders to repatriate them;

(b) A portion of the other half represents legal currency reserves which are not available for meeting balance of payments deficits without changes in central banking and currency laws or customary practices;

(c) The largest part of the remainder represents working balances which are needed to maintain the flow of international trade. It is difficult to estimate how much of the total would be regarded as the minimum level below which working balances could not be permitted to fall.

2. The adequacy of the total amount of foreign gold and dollar reserves should not be judged by a simple comparison with levels prevailing in the 'thirties. The increase from the end of 1937 to March 1947 has been estimated at \$7 billion by the Commerce Department.

(a) Price changes must be taken into account. Wholesale prices have risen by 73 per cent from 1937 to March 1947, whereas the rise in balances has been 54 per cent.

(b) There is much greater need for dollar balances today than in the 'thirties, because (1) the shift toward the United States in the geographical composition of the import trade of foreign countries has made it necessary for them to concentrate their working balances in the United States rather than distribute them in a number of countries, and (2) the existence of a sellers' market makes it frequently necessary for importers to pay cash in advance, in contrast to prewar credit arrangements, and therefore to hold larger dollar balances.

(c) Use of 1936 or 1937 as a basis of comparison may seem to imply that the volume of gold and dollars in the hands of foreign countries at that time was plentiful or at least adequate. The fact is that throughout the 'thirties there was a net loss of gold and dollars from all parts of the world. Latin America was suffering throughout the 'thirties from a severe dollar shortage, while as for Europe the fact that gold and dollar resources were not considered adequate is evidenced by the general application of exchange controls, especially with regard to dollar payments.

3. Apart from the overall deficiency of dollars, there is maldistribution, as evidenced in part by the trend in dollar balances since 1937. Between the end of 1937 and January 1947, Europe's balances rose from \$1 billion to \$2.5 billion; Asia's balances from \$400 million to \$1.3 billion; and Latin American balances from \$280 million to \$1.1 billion. A substantial fraction of the present total of \$20 billion of gold and dollar holdings is held by countries which are not likely to draw upon their holdings in the immediate future, e.g., United Kingdom, Switzerland, Russia, Cuba, and Venezuela; gold formerly held by Germany and Japan is in Allied hands awaiting disposition.

Nor can it be assumed that dollars will be easily shifted from surplus areas to the places of greatest need. With but one or a few exceptions (such as Switzerland), all countries have been losing reserves the past year, and there is little likelihood that any would make loans of gold or dollars of the type and for the duration necessary to overcome dollar shortages on the part of other countries.

#### Conclusion

In conclusion, the gold and dollar balances of foreign countries are (1) lower in real terms than they were in the 'thirties and (2) considerably lower, in amount actually available to meet dollar needs, than they would appear. In view of the fact that gold and dollar balances, as well as the available portions of dollar loans and grants, are limited in amount and unevenly distributed, a number of foreign countries may be forced to place further restrictions on imports unless present resources are supplemented by new financial assistance from the United States.

ECONOMIC RECOVERY IN BRITISH MALAYA

A. B. Hersey and J. B. Churchill

British Malaya is the wealthiest colonial region of the Empire and the most prosperous and contented political unit<sup>1/</sup> in the tropical East. The prewar Malayan economy centered in the production and processing for export of rubber and tin, and in the entrepot trade of the Straits Settlements. These industries were the means of obtaining a larger net volume of dollar exchange than was derived from any other British colony. In the years 1935-39, Malaya was the producer of 42 and 33 per cent, respectively, of the world supplies of rubber and tin. Most of its food and nearly all finished manufactures were imported. In times of high prices the comparative advantage of rubber production over food growing discouraged the latter. Every serious fall in the world demand for rubber and tin left Malaya with little to run its elaborate system of government services except the surplus of revenue over expenditure accumulated in better years.

The Japanese made no important contribution to Malaya's economic development during their occupation and departed leaving the economy generally stagnant and seriously impaired. The policy of the British Military Administration, and of the British civil government which succeeded it on April 1, 1946, has been the restoration of prewar economic conditions. Except for plans calling for an increase in domestic food production, the British Government has indicated no intention to alter the basic character of the Malayan economy by such means as the development of local consumer industries.

In response primarily to shortages of staple foodstuffs, textiles, and housing, together with a marked increase in currency circulation over prewar, the Malayan cost of living index, after declining somewhat from a peak reached in February 1946, at the end of that year stood at three times the level in 1941. A lowered standard of life was evidenced in a textile consumption in 1946 reduced by more than one-half since 1939, generally inadequate housing in the cities together with negligible new construction, and extremely short food rations. In more recent months these conditions have been substantially alleviated. Improvement in the supply of food and textiles has helped to solve the problem of labor supply in the export industries.

In contrast to these favorable developments, the resumption of large-scale production of natural rubber, coming at a time when postwar backlogs of demand for rubber were beginning to be met with the help of synthetic output, has been followed by a great drop in the price of rubber. Malaya's merchandise trade accounts, approximately in balance last year, will tend to show a deficit in 1947. One possible outcome is a curtailment of imports of textiles and other consumer goods.

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<sup>1/</sup> Formerly the nine native states of the Malay Peninsula under British protection were divided into four Federated Malay States and five Unfederated Malay States. The Straits Settlements, which included Singapore, Penang, Malacca, and Labuan, were a Crown Colony comprising the chief ports of the peninsula. British Malaya was redivided after the war into two new political entities, namely, the Malayan Union (including all areas but Singapore) and the Colony of Singapore.

### Food Supply

In the restoration of the Malayan economy perhaps the greatest emphasis has been placed on the revival of food imports on the prewar scale. Net food imports in 1939, amounting to U.S. \$52.4 million, were 40 per cent of the value of total imports for domestic consumption. Rice is the principal staple article of diet, but Malaya produced in the prewar years 1936-40 only 34 per cent of its total annual consumption of nearly 1 million tons. The 1946 harvest (January-March) was 70 per cent of prewar, and the output in 1947, despite an increase of 8 per cent over prewar in the area planted to rice, was only 83 per cent of prewar. According to estimates made in May by the International Emergency Food Council (I.E.F.C.), imports in 1947 will amount to 326,000 tons or 52 per cent of the average annual net imports in the 1936-40 period. Thus the total rice supply will be 62 per cent of prewar. Most of the imports will come from the major prewar rice-exporting countries of Burma, Siam, and Indo-China. Although the probable combined exports of these countries in 1947 will be less than 25 per cent of the prewar average, a large part of the available supply will go to neighboring countries, including Malaya.

The rice deficiency will be partly offset by increased consumption of wheat and wheat flour. Prewar net imports of wheat flour averaged around 60,000 tons; imports of wheat were insignificant. The import allocation of the I.E.F.C. for the year 1946-47 is in the region of 450,000 tons of cereals other than rice. This is mainly wheat and wheat flour in unknown proportions. About 90 per cent of the allotment is expected to be delivered.

The overall food supply would be close to a normal level were it not for a 15 per cent increase in population from 6.0 to 6.9 million.

### Labor Supply

In spite of this augmentation of population, the available labor force at the end of 1946 was estimated at little more than one-half of prewar. Malayan rubber plantations and tin mines, as well as public services, have always been dependent upon transient labor imported mainly from India and Southern China. (The great majority of native Malays are self-sufficient food cultivators and fishermen.) In prosperous years British Malaya has been able to absorb many thousands of Chinese and Indians whereas poor years have brought about large-scale emigration. The population in 1941 was roughly 43 per cent Chinese, 37 per cent Malays, 14 per cent Indians, and 6 per cent Europeans, Eurasians, and others. The war resulted in the removal or death of some 200,000 persons, mainly Chinese and Indian workers. Repatriation of Indians to India is now proceeding at the approximate rate of 20,000 annually, and no net immigration from China has been reported since the war. In addition, there has been a considerable shift of working population into the cities. With the reopening and rehabilitation of large-scale enterprises and the arrival of European personnel and equipment, the shortage of labor outside the cities has become keenly felt. In the cities and elsewhere there has been an unexampled volume of strikes, for which explanations may be found both in difficult living conditions and in the growing political consciousness found among most Asiatic peoples in recent years. Between the first of this year and the middle of May about 12 per cent of Singapore's 120,000 workers were intermittently engaged in strikes, and 375,000 man-days of labor were lost. Probably the most damaging strikes have been those in Malaya's single coal mine.

There exists no adequate measure of the effect on economic recovery of the qualitative deterioration of population resulting from the Japanese occupation. The health and strength of the people, seriously impaired by malnutrition and disease, had registered noticeable improvement by the end of 1946.

### Fuel Supply

The resumption of coal mining and coal imports at the prewar level is a prerequisite to the revival of tin mining and smelting and transportation. Fuels are the only essential raw materials which must be imported.

Petroleum for domestic consumption, amounting in 1939 to 724,000 long tons and costing U.S. \$18.5 million, was supplied at that time by the Netherlands Indies and British North Borneo, where production has only recently begun to recover. During the last four months of 1946, net imports of petroleum were received at an annual rate of 710,000 long tons, including an increased proportion of fuel oil and smaller imports of the higher-cost products. Although shipping distances were longer than before the war, this shift in composition, together with the fact that prices had not risen much, left the total cost of petroleum imports lower than prewar. The supply position for coal has been slow to improve: production in 1946, inhibited more by strikes than by war damage, was only about two-fifths of average annual output in the period 1936-38 which amounted to 544,000 long tons. Domestic consumption of coal in 1939 also included net imports of 615,000 tons valued at U.S. \$3.3 million. Coal imports in the last quarter of 1946 were proceeding at an annual rate of only 175,000 long tons. The cost per ton was five times prewar.

### Transportation

Restoration of the major portion of war damaged transportation and communications has been completed. Harbor dredging and wreck removal were well advanced by the end of 1946, and destroyed storage sheds were rebuilt. At Singapore 70 per cent of the transit sheds and 30 per cent of the port's other storage facilities had been destroyed. The rate of unloading, and hence the turn-around rate of vessels, remains low due to labor shortages enhanced by strikes in the harbor areas. Lighterage facilities at Singapore have been improved by the purchase of a considerable number of tugs and barges from the British Admiralty. In August 1946 Penang's volume of trade had recovered to the prewar monthly average. The local inter-island trade is seriously affected by the unsettled political conditions in the adjacent Netherlands Indies and by shortages of medium-sized craft. Coastal shipping may be expected to recover normal operations with the delivery of large numbers of vessels now on order.

A considerable portion of the railroad system was removed by the Japanese to Siam. Most of this the Malayan Government hopes ultimately to recover; a minor part has been returned to date. The occupation resulted in the removal of 254 miles of track, the destruction of 36 bridges and the removal of 45, the removal of 27 per cent of the locomotives and heavy damage to at least as many more, the removal of 51 per cent of the freight cars and destruction of 25 per cent of the passenger cars, and the destruction of 60 per cent of the central railroad workshops. As the result

of recoveries from Siam and purchases from the U.S. Army and the United Kingdom, the number of freight cars is expected to be completely recouped by mid-1947. Orders for new equipment have been placed in the amount of S\$41 million (U.S. \$19 million). New locomotives have been acquired in unknown numbers, and substantial progress has been made in the reconstruction of track and bridges. Service on the rehabilitated railways has been curtailed due to the coal shortage.

#### Rubber and Tin

Malaya's potential rubber production was only slightly impaired during the Japanese occupation. From five to ten per cent of the plantation rubber trees were destroyed by felling and through damage resulting from inattention. The damage suffered by small holdings, composing 40 per cent of the total acreage in 1940, is taken to be almost negligible. Altogether 4.2 per cent of the acreage under rubber in 1941 was destroyed by felling. No specific estimate of the very considerable damage and deterioration suffered by estate buildings, machinery, and vehicular transport is available. Equipment for tapping and collecting rubber was largely lost or worn out, so that it required almost complete replacement. The best available index to the extent of rehabilitation is the quantitative revival of production: In the first postwar year under civil administration, rubber production was 525,000 tons, or 87.5 per cent of estimated production in the best prewar year, 1941, when output was no longer being curtailed under the international export restriction agreement then in effect. Production in 1947 is presently estimated at 103 per cent of 1941 output. These figures, however, partly reflect temporary flush yields of latex from rubber trees untapped and rested during the war.

Malayan tin mines sustained major damage. Their very limited postwar output is also the consequence of shortages of coal, machinery imports, transportation equipment, and skilled labor and supervisory personnel. Tin dredges normally account for about 55 per cent of production. Of 95 dredges in operation in the peak period of prewar operations, only 14 were operating and 24 were in various stages of rehabilitation at the end of September 1946, the most recent date for which figures are available. Some dredges, ready to produce, remained inoperative due to the coal shortage; other dredges and power stations had begun the extended process of fuel conversion to the use of wood and diesel oil. For mines not using dredges, all engineering tools and stores required replacement. Total output in 1946 was 8,432 tons, or less than 10 per cent of production in 1940, the best prewar year.

The Malayan Government has authorized loans to the tin mining companies up to £2.5 million, and to the rubber-growing industry in the sum of £7.5 million. The amounts made available to both industries will be set off against admitted claims for war damage.

Rates of duty imposed by the Malayan Union Government on the export of domestic produce have been substantially reduced in recent months despite a shortage of revenues relative to present requirements. The former specific duty on rubber, already reduced from S\$0.04 to S\$0.0275 per pound in November 1946, was replaced on February 24 by a 5 per cent ad valorem duty.

(The Straits dollar is worth U.S. 47 cents.)<sup>1/</sup> Between February 24 and May 15 the price fixed for rubber for the purpose of assessing the new duty was successively reduced from S\$0.41-7/8 to S\$0.34-3/4 per pound. Agitation is reported continuing for further reduction of the duty.

Value of Rubber Exports

Neither the tonnage or price per ton of Malayan rubber exports in 1947 can be predicted with certainty. In consequence of the great revival of rubber production in the Far East, the industry is in a precarious position owing to the high cost of living and other prices in Malaya, competition with the synthetic product, and a declining price for natural rubber. Crude rubber imports into the United States from all sources in 1946 had an average declared value of 27.2 cents a pound,<sup>2/</sup> as against 16.4 cents in the 1936-40 period. Between early May 1947 and the latter part of June, the U.S. market price of standard quality rubber fell from 25 cents to 14 cents a pound.

The table on the following page shows the essentials of the world rubber demand and supply picture, on the assumption of maintenance of industrial activity. Consumption last year exceeded the prewar average by 40 per cent but the increase was more than covered by the output of synthetic rubber. Consumption has now reached its peak for the immediate postwar period. Although synthetic production is expected to go on declining, the anticipated rise in natural rubber output probably will result in a steady growth of world stocks, at first in consuming countries and eventually, no doubt, in producing countries.

Consumption of rubber already has leveled off because inventory demands for tires now have been largely satisfied. Ordinarily between 60 and 75 per cent of total rubber consumption is in the manufacture of tires and tubes.

The continuation of synthetic production in the United States, mostly in government-owned plants, is likely (1) in view of its strategic value, and (2) because it provides a check against the possible reinstatement of price-raising restriction agreements among foreign producers.

The competition between natural and synthetic rubber is a matter of use as well as of price. Consumers entertain a definite bias in favor of natural rubber for many uses. For the manufacture of tires and tubes natural rubber has decisive advantages, including lower processing costs. It is expected, therefore, that U.S. government controls, which still require a usage of from 51 to 67 per cent of synthetic in various manufactures, will be progressively modified as the supply of natural rubber expands. This does not preclude the possibility that present shortcomings of Buna-S will be overcome or that still newer materials will be developed to serve automotive needs.

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<sup>1/</sup> The legal parity with sterling is S\$1 = 2s.4d. This is equivalent, at the sterling-dollar rate of \$4.03, to U.S. 47.0 cents. During 1946 Singapore bank selling rates for the U.S. dollar averaged S\$1 = 47.1 cents and their buying rates 47.6 cents.

<sup>2/</sup> The average Singapore export price in the last five months of 1946 was equivalent to about 21 cents a pound, and in the first three months of 1947 about 20 cents a pound.

Prospective Rubber Position<sup>a/</sup>  
(Thousand long tons)

	<u>1936-39</u>	<u>1946</u>	<u>1947</u>	<u>1948</u>
Supplies Available in Countries of Consumption:				
Natural	955 <sup>b/</sup>	850	1,200	1,400
Synthetic	68 <sup>c/</sup>	940	700	550
Total Supply	1,023	1,790	1,900	1,950
Rubber Consumption:				
United States	538	1,018	980	889
United Kingdom	111	130	160	180
Other countries	466	452	560	606
Total Consumption	1,115 <sup>e/</sup>	1,600	1,700	1,675
Increase in Stocks in Consuming Countries	d/	190	200	275
Stocks in Consuming Countries at End of Period <sup>e/</sup>	296 <sup>f/</sup>	620	820	1,095
Total World Stocks at End of Period	571 <sup>g/</sup>	1,020	1,220	1,495

a/ Except for 1936-39, estimates of Rubber Study Group (Economist, June 21, 1947, pp. 990,991).

b/ Net imports (McFadyean, History of Rubber Regulations, 1934-1943, p. 235).

c/ Estimates of London Rubber Secretariat (Economist, June 21, 1947, p. 989).

d/ Data on year-end stocks (footnotes f and g) show a smaller decrease than do the data used here for average supplies and consumption.

e/ Excluding quantities in transit and afloat.

f/ McFadyean, p. 237. (Excluding stocks at export ports and afloat.) Excludes synthetic. Average of year-ends 1936-39.

g/ McFadyean, pp. 237 and 238. Excludes synthetic. Average of year-ends 1936-39.

The established price of Buna-S has been 18.5 cents a pound since 1943. Costs of production were for a long time higher than this, but since the war it has been possible to shift to a cheaper process using cheaper raw material (petroleum refinery products instead of alcohol) and costs have been brought in line with the selling price, with prospects of a further decline. This creates an additional element of weakness in the natural rubber price structure.

There is little reliable information about the amount of rubber which can be produced profitably under present cost conditions in producing countries. In Malaya the increased output has come largely from small holders, who in 1946 produced 57 per cent of the total. Although their

costs of production have always been below the costs of production on estates, the recent drop in the price of rubber below the prewar level has reportedly led to an immediate decline in their output. With food and textile prices in Malaya three to five times prewar, growers are under considerable pressure to shift to producing their own food. Increased labor costs to estate producers have been estimated at between 100 and 200 per cent above prewar. These and other costs have eaten deeply into plantation profit margins.

In view of these price-cost relationships and the fact that Malayan output has already recovered its prewar level, little or no further increase in production is expected in the near future. The increased world output shown in the projection given above is explained chiefly by an increase in the quantity expected to become available from the Netherlands Indies.

It is evident, in view of the recent decline in the price of rubber, that the total dollar proceeds of rubber exports from Malayan production are not likely in the near future to match the amounts realized in the early months of 1947. Recovery of rubber exports was largely completed by August 1946. The net quantity exported in the seven-month period August-February 1947 was about 365,000 long tons,<sup>1/</sup> almost exactly equivalent to the 620,000 ton annual rate of production presently estimated for 1947. Exports in the year 1947 will probably average about the same. The exceptionally large exports that were recorded for March-May may be offset in later months by reduced shipments at the lower prices now ruling. For the year as a whole, Malayan net proceeds from rubber (including the exchange profit on re-exports)<sup>2/</sup> will undoubtedly fall short, by several tens of million dollars, of the \$328 million annual rate that was being realized in August-February.

#### Value of Tin Exports

The world shortage of tin, due in large measure to the inability of Malaya and the Netherlands Indies immediately to resume their prewar output, and the forced reliance of the chief buyers on inferior high cost ores, has resulted in a continuing tendency toward rising world prices for tin. The British Ministry of Supply is the sole buyer of tin metal in Malaya. On September 26, 1946, the price ex-smelter was increased from £330 to £370 per ton, and on March 29, 1947, increased again to £422 per ton. This contrasts with £202 per ton, the average price at London during the years 1931-40.

According to estimates made by the Tin Study Group, meeting in April of this year, world output will not equate with world consumption before 1949, in the absence of a general business recession. The estimates of production, particularly for Malaya, represent sizeable reductions from previous estimates.

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<sup>1/</sup> Inconsistencies between the presently available quantity and value figures for February suggest that the 7-month total of 337,000 tons must be raised to about 365,000 tons.

<sup>2/</sup> In the seven months August-February, imports of Sumatran and other rubber into Malaya (which have been deducted in calculating net exports) amounted to 163,000 long tons. There was an unusually large margin between the unit values (per ton) of imports and exports.

Prospective Tin Position  
(Thousand long tons)

	<u>1936-39</u>	<u>1946</u>	<u>1947</u>	<u>1948</u>	<u>1949</u>
Production:					
Malaya	60	8	22	48	70
Other	<u>123</u>	<u>84</u>	<u>95</u>	<u>115</u>	<u>131</u>
	183	92	117	163	201
Absorption in consuming countries	171	116	<u>140-150</u>	<u>184</u>	<u>190</u>

While the tin price situation is comparatively favorable for Malaya, the volume of tin exports will still be relatively small in 1947. In 1936-39 the average yearly net export value of tin (including foreign exchange earnings on a small amount of re-exports) was U.S. \$60 million, compared with U.S. \$143 million for rubber. In 1947, despite high prices, tin proceeds will probably be less than U.S. \$40 million.

Ability to Pay for Imports

Malaya's favorable balance of merchandise trade in 1939, representative of prewar years, was U.S. \$60 million. Statistics that are now available for the seven months August 1946-February 1947 show only a small favorable balance, and it seems probable that a deficit will develop in 1947. Service and remittance charges make for an even larger deficit in the overall balance of payments. It is probable, therefore, that import restrictions, in the form of control over the release of foreign exchange for purchases from the United States and other non-sterling areas, will continue to be enforced.

During the seven months August 1946-February 1947, Malayan imports totaled S\$719.8 million (U.S. \$338 million) and exports S\$732.8 million (U.S. \$344 million). Except for rubber and tin, most exports were reshipments of imported goods. Even in the case of rubber, imports accounted for about one-fifth of the total value of exports.<sup>1/</sup> An arbitrary minimum estimate of imports for domestic consumption of all commodities other than rubber and tin (given by the excess of imports over exports of such commodities) amounts to S\$422 million for the seven-month period, equivalent to an annual rate of U.S. \$340 million.<sup>2/</sup> Net exports of rubber and tin were at an annual rate of U.S. \$351 million.

The total of net imports for domestic consumption was made up as follows:

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- <sup>1/</sup> In terms of tonnage, imported rubber accounted for over one-fourth of total exports.
  - <sup>2/</sup> This is a minimum estimate of the value of retained imports, since deduction of total export values (other than rubber and tin) is excessive for two reasons: (1) not all these exports were actually reshipments of imports; (2) the values of re-exports are higher than those of the same goods when imported.

Grains and flour	16 per cent
Other food, drink, tobacco	28
Textiles and apparel	23
Fuels	6
Machinery and transportation equipment	8
All other	<u>19<sup>a</sup></u>
	100 per cent

a/ The understatement of imports for domestic consumption probably occurs chiefly in this miscellaneous category.

In the absence of sufficiently detailed quantity and price data, it is possible only to make certain general comparisons with prewar net imports. The proportion of textile imports has been substantially greater than prewar (at least in current value terms) and requirements are likely to remain high through 1947. On the other hand, net imports of raw materials and miscellaneous consumer goods have been relatively low. The value of net petroleum imports now constitutes a much reduced fraction of total net import costs as compared with prewar, but this change results largely from price factors rather than from any substantial reduction in the quantity imported. Imports of staple foodstuffs have been somewhat smaller in absolute tonnage than in 1939, but they are expected to increase in 1947 to about the 1939 level.

The total value of imports for domestic consumption in 1947 will evidently tend to be somewhat larger than the annual rate of \$340 million shown in August 1946-February 1947. To finance these imports and to provide exchange for remittances and service charges, Malaya's only significant export resources are rubber and tin. As was shown above, the earnings from rubber and tin are likely to be less than \$351 million in 1947. A deficit in Malaya's over-all balance of payments is therefore in prospect, unless a more severely restrictive import policy is adopted.