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(2nd copy)

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Division of Research and Statistics
International Sections

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REVIEW OF FOREIGN DEVELOPMENTS

May 6, 1947

The Balance of Payments and the Dollar Deficit of the United Kingdom.....	1
Note on Monetary Developments in Peru, 1939-46....	10
Exchange Control in Italy - II.....	11
Quadripartite Report on Germany.....	14
Russian Industry in the First Quarter of 1947.....	25

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The Balance of Payments and the Dollar Deficit
of the United Kingdom

C. R. Harley

The White Paper National Income and Expenditure of the United Kingdom, 1938 to 1946 (Cmd. 7099), presented to Parliament in April, contains a more detailed estimate of the British balance of payments for 1946 than has heretofore been available. The two principal balance of payments tables from that paper are reproduced on the following page.^{1/} A very brief discussion of the current account data presented therein and of the official British estimate of the deficit expected for 1947 serves as an introduction to a discussion of the factors which may cause a divergence between the total deficit on current account and the deficit payable in hard currencies. A final section is concerned with an attempt to provide a geographical breakdown of both the current and capital accounts of the 1946 balance of payments in such a way as to clarify the complex relationship existing in the recent past between the total and the dollar deficits. Although no estimate of the possible divergence of these sums in 1947 is attempted, the data supply necessary groundwork for future forecasts of this type.

^{1/} For the convenience of readers who may not have access to the original data, the explanatory notes contained in the White Paper with reference to these tables are included on p. 9. An additional table from the same document, showing the distribution of the external liabilities of the United Kingdom by areas and by types, is also presented.

Tables 1 and 2
Balance of Payments

1. Current Account
(£ million)

Payments	1938	1946	Receipts	1938	1946
1. Imports (f.o.b.):			10. Exports and re-exports	533	890
(a) Food and drink	...	555	11. Shipping	100	150
(b) Tobacco	...	70	12. Interest, profits and dividends	205	150
(c) Materials	...	360	13. Other (net)	100	72
(d) Petroleum	...	60			
(e) Other	...	65			
Total	835	1,110			
2. Government expenditure:					
(a) Military (net)	...	225			
(b) Relief and rehabilitation	-	97			
(c) Cost of Germany (net)	-	38			
(d) Other (net)	...	-60			
Total	16	300			
3. Shipping	80	140			
4. Interest, profits and dividends	30	70			
5. Film remittances (net)	7	17			
6. Tourist payments	40	25			
7. Total payments	1,008	1,662			
8. Balance on current account	-70	-400			
9. Total payments <u>less</u> deficit	938	1,262	14. Total receipts	938	1,262

2. Capital Account
1946
(£ million)

15. Gold and U.S. dollar reserves	61
16. United States and Canadian lines of credit	-279
17. Other loans to H.M. Government	38
18. Net sterling, etc., liabilities	-148
19. External capital assets	-70
20. Subscriptions under Bretton Woods Agreement Act, 1945	33
21. Other	-35
22. Total external investment (equal to balance on current account)	-400

The total deficit on current account for 1946 is estimated at £400 million. This is £50 million less than the provisional estimate included in the Economic Survey for 1947^{1/} and little more than half the deficit generally forecast for 1946 at the time the Anglo-American Financial Agreement was negotiated in the closing months of 1945.

That the actual deficit for the year was substantially less than the expected deficit is not accepted by the British as reason for unmixed rejoicing. The expected deficit was cut not only by a gratifying recovery of United Kingdom exports to a volume roughly equal to that of 1938, but also by the failure to obtain needed imports of raw materials and industrial equipment to the extent anticipated. According to official indexes, the volume of total imports in 1946 was only about 70 per cent of the 1938 volume. Imports of raw materials lagged to approximately the same extent and British writers have estimated that raw material stocks held in the country were drawn upon to the value of £200 million during the year. Mr. Dalton's disclosure in Parliament that only 5 per cent of Britain's total expenditures in the United States in the last six months of the year represented purchases of industrial machinery caused widespread concern over the extent to which the United States' loan is being expended for consumption goods. World-wide shortages of raw materials and heavy competing demands for industrial equipment were doubtless the major barriers to a more rapid expansion of United Kingdom imports during the year. Contributing factors may have included both the long delay in placing orders resulting from the protracted consideration of the British loan in Congress, and the reluctance of British industrialists to speed capital re-equipment in the face of the political and social changes accompanying the advent to power of a Labor Government.

As a result of the recovery in exports and the lag in imports the adverse balance on merchandise account in 1946 was actually smaller than in 1938 despite the fact that the level of import and export prices in 1946 (in terms of sterling) was about double that of the earlier year.^{2/} The increase in the total adverse balance as compared with 1938 was attributable primarily to heavy Governmental expenditures abroad and to the sharp decrease in British net income on interest and dividend account.

The Economic Survey for 1947 presents the target figure of £350 million for the total deficit of the United Kingdom on international account for the current calendar year and provides the following abbreviated balance of payments estimate:

<u>Payments</u>	(£ million)	<u>Receipts</u>	(£ million)
Imports	1,450	Exports and re-exports	1,200
Net Government expenditures	175	Net invisible income	75
Deficit	<u>-350</u>		
	1,275		<u>1,275</u>

^{1/} Cmd. 7046. Reprinted in the Federal Reserve Bulletin for April 1947.

^{2/} In addition the terms of trade had become more unfavorable for the United Kingdom; on the base 1938=100 the index of average values for exports in 1946 was 195, that for imports 205.

The Survey points out, however, that the dollar deficit may well exceed the total deficit. In the absence of voluntary or involuntary capital movements, the current account deficit and the dollar deficit would be equal (if the "dollar deficit" is understood to mean the deficit payable in freely convertible currencies or in gold). Several types of capital movements will tend to destroy the equality. The potential drain on the dollar (and gold) resources of the United Kingdom will be increased to the extent that:

- (1) the United Kingdom accepts inconvertible currencies (from, e.g., certain European nations) in payment for net exports of goods and services;
- (2) sterling balances previously accumulated to the credit of Britain's trading partners are released for current payments--whether these payments are made in the United Kingdom or in dollar areas.^{1/}

The potential drain of dollar resources will be reduced to the extent that:

- (1) the United Kingdom is able to reduce its holdings of inconvertible currencies in the payment of current deficits with the countries issuing those currencies;
- (2) countries experiencing a favorable current balance with the United Kingdom increase their sterling holdings;
- (3) the United Kingdom is able and willing to liquidate a portion of its foreign investments to pay for imports of goods and services.^{2/}

To meet the demand for dollars resulting from current and capital transactions in 1947 and subsequent years the United Kingdom can draw upon its gold and dollar reserves, which amounted to £642 million on December 31, 1946; and upon the United States' and the Canadian lines of credit, of which the undrawn balances totaled £955 million on the same date. Liquidation of a portion of Britain's foreign investments in payment of claims against the United Kingdom has already been negotiated^{3/} in connection with the sale of British railroads in Argentina, and it is probable that comparable settlements will be arranged in the future. To the extent that

^{1/} Liquidation of other types of capital assets held in Britain by foreign investors also would tend to increase the potential drain on dollars; however, the United Kingdom is likely to exercise continued and rigid control over capital movements of this type.

^{2/} Foreign countries can prevent this type of capital movement, but may not do so if their international financial positions are strong. In general it is probable that the United Kingdom will not seek to liquidate any substantial volume of its foreign investments except to reduce its capital indebtedness, represented in large part by foreign holdings of sterling balances.

^{3/} See this Review, February 25, 1947.

capital assets and liabilities are offset in such transactions, the British dollar position is not immediately affected. Inasmuch, however, as the average interest and dividend return from British investments abroad exceeds the cost of servicing foreign claims on the United Kingdom, an adverse effect on the current balance of payments may be expected to result from settlements of this type.

Before attempting to appraise the quantitative importance of the factors making for divergence of the dollar deficit from the total current account deficit by examining British capital account transactions for 1946, a word should be said concerning British receipts of South African gold. South Africa has agreed to sell to the United Kingdom £80 million of gold annually.^{1/} The greater portion of the sterling thereby acquired by South Africa necessarily will be used to meet that country's current deficit with the United Kingdom. The balance will probably be used to repatriate British-owned investments in South Africa or to build up South Africa's sterling balances. Accordingly, British acquisitions of South African gold are reflected in the net current account balance of the United Kingdom, in the liquidation of British overseas investments, and in the net change in sterling liabilities and need not be considered separately in examining the relationship between the total and the dollar deficit.

In order to provide a more adequate basis for estimating the probable order of magnitude of the British dollar deficit in 1947 (although no such estimate is undertaken in this article), a very rough geographical breakdown of the 1946 British balance of payments, both current and capital accounts, has been attempted. Little confidence should be placed in any specific figure shown in the following table. With the exception of the trade statistics, only fragmentary information is available as to the distribution of Britain's international income and outlay and the following summary figures represent a combination of guesses, specific data for isolated transactions, and more or less automatic distributions of known totals in various, supposedly-logical, proportions.^{2/} The usefulness of the material lies in the fact that the relationship between the total deficit and the dollar deficit in 1946 is clarified so that approximate conclusions may be drawn as to the effect which changes in the various portions of the balance of payments will have upon the future dollar position of the United Kingdom.

It is apparent from table 3, for example, that Australia and New Zealand, despite a favorable balance with Britain, delivered dollars to the United Kingdom against an increase in their sterling balances. This type of transaction may be expected to continue as long as these areas continue to have a favorable balance in their trade with the world as a whole and choose to hold their reserves in sterling. India reduced its sterling balances partly to pay for net imports of goods and services

^{1/} The United Kingdom undertakes to furnish up to £10 million in dollars to South Africa if required to meet that country's current deficit with dollar areas. This provision is not likely to become effective since South African gold production (less the gold sold to the United Kingdom) will presumably be adequate to finance South Africa's adverse balance with countries other than the United Kingdom.

^{2/} Broad geographical breakdowns for changes in the foreign liabilities of the United Kingdom are available from the table shown on p. 8.

Table 3
Approximate Distribution of United Kingdom Balance of Payments in 1946
(£ million)

	Total	Inter-national	Austral. & New Zealand	India	South Africa	Other Sterling Area	Europe	Canada	U.S.	Central & South America	All other	Un-allocated
U.K. Balance on Current Account	-220 ^{a/}		-46	+15	+57	+15	+141	-140	-158	-98	-6	
Merchandise	-180 ^{b/}		+34	+17	+33	-72	-169	+1	-3	+27	-48	
Services	-400		-12	+32	+90	-57	-28	-139	-161	-71	-54	
Total												
U.K. Balance on Capital Account	-61 ^{d/}	+7 ^{e/}	-39	-17	-65	+69	-55 ^{f/}	+23	+23	-23	+51	-35
1. Use of gold and U.S. dollar reserves	+279							+132	+147			
2. Use of U.S. and Canadian lines of credit	-38						-13	-16	-9			
3. Payments by U.K. on other Government loans	+148	+26 ^{e/}	+51	-35	-55	-12	+96 ^{f/}			+74	+3	
4. Increase in net sterling, etc., liabilities	+70			+20	+30					+20		
5. Decrease in external capital assets	-33											
6. Subscription to Bretton Woods	+35											+35
7. Other	+400		+12	-32	-90	+57	+28	+139	+161	+71	+54	
Total												

a/ Data of movements of goods through customs, presented in U.K. trade statistics by countries, adjusted proportionately to agree with the White Paper data for total imports f.o.b. foreign country and total actual receipts from exports.

b/ All non-merchandise items of the current balance. Distribution of component items by areas has been roughly estimated. Relief contributions, military expenditures, and the cost of Germany are responsible for the large estimated deficit of the U.K. with Europe.

c/ The signs used in table 2 of the White Paper have been reversed in this table to agree with U.S. practice in balance of payments reporting. All figures present transactions from the point of view of the U.K.

d/ Of this figure note that £35 million (offsetting the £35 million shown in line 7) is not allocated by country; if the amount in line 7 could be distributed by areas, the figures for those areas in line 1 (which are in most cases residual amounts) would have to be adjusted correspondingly.

e/ The United Kingdom paid approximately £7 million in dollars on its subscription to the World Bank in 1946; the rest of the subscription payments was made in sterling (or sterling demand notes) and is presumably reflected by an increase in British sterling liabilities.

f/ Includes a minus £50 million in line 1 and a plus £50 million in line 4 reflecting payment of that sum in gold to the United Kingdom by France in partial settlement of clearing indebtedness--see text.

from the United Kingdom and partly (insofar as the data may be accurate) in repatriation of Indian capital held by British investors.^{1/} The table suggests that India surrendered a moderate amount of dollars to the United Kingdom. This may have been possible during the first half of the year; during the later months of 1946, an adverse balance with hard currency areas was reported by India. South Africa apparently met its adverse balance with the United Kingdom by shipping gold and liquidating some of its sterling holdings, while it used further amounts of its sterling balances to repatriate British-owned investments in South Africa. The rest of the sterling area appears to have received payment in dollars for its net sales of goods and services to the United Kingdom and, in addition, to have exchanged a limited amount of sterling for dollars.

Although recorded trade statistics show that United Kingdom merchandise exports to Europe exceeded imports from Europe by about £140 million, much of this excess is attributable to relief shipments for which no payment was received. Moreover British military expenditures and occupation costs in Continental areas were heavy. Accordingly the net adverse balance of the United Kingdom on current account, as shown in the table, does not appear unreasonable. The large receipt of gold from Europe may be explained by the known transfer of £50 million in gold to the United Kingdom in partial settlement of a continuing French clearing deficit. The increase in net sterling, etc., liabilities of the United Kingdom vis-a-vis Europe appears surprisingly large, but it is apparent from the "etc." that it includes an adjustment for net British liquidation of non-convertible European currencies during the year. £50 million of the increase may therefore be attributed to the liquidation of the French franc clearing balances mentioned above. Furthermore, the estimate is supported by the White Paper table reproduced on page 8, on the assumption that £13 million of the payments on Government loans shown in line 3 of the capital account represents the extension of credit by the United Kingdom to Russia. It will be noted, however, that table 4 shows the net increase in sterling liabilities to Europe and to European dependencies combined. To the extent that European dependencies increased their sterling holdings, both the "Europe" column and the "all other" column of table 3 are subject to revision.

Drawings upon the United States and Canadian lines of credit were the principal capital account transactions with those countries. The items of £16 million and £9 million are estimates of amortization payments on the interest-free loan of \$700 million extended to the United Kingdom by Canada in 1942, and on the United States Reconstruction Finance Corporation loan of 1941.

In the capital account of the United Kingdom with Central and South America, the apparent increase in the sterling balances of the latter areas is somewhat larger than can be supported by data from other sources. Again, however, the figure is in agreement with data presented by the White Paper table on the assumption that line 3 of the capital account has been correctly handled. The "all other" column of table 3

^{1/} Private Indian capital seeking investment in the United Kingdom would have the same effect on the British balance; it is believed that some capital movement of this type occurred.

indicates that the United Kingdom paid in dollars for most of its net imports from countries and areas not shown separately in the table.

It will be apparent to the reader that all the figures presented are inter-dependent and that each error must be offset by a compensating error. The capital account estimates are dependent upon the current account estimates and no precision is claimed for either. It is unlikely, however, that much more definite information will become available and the general picture here presented may prove a useful tool for understanding future developments in Britain's international accounts.

Table 4
External Liabilities by Areas and Types
(£ million)

	Outstanding on Dec. 31		
	1944	1945	1946
Sterling Area			
Dominions ^{a/}	390	481	444
India, Burma and Middle East	1,524	1,929	1,883
Other sterling area countries	477	561	593
Total sterling area	2,391	2,971	2,920
North and South America	346	519	847
Europe ^{b/}	378	273	356
Rest of world	56	62	91
Total external liabilities	3,171	3,825	4,214
Net sterling, etc., liabilities ^{c/}	2,887	3,332	3,480
External loans	284	493	734
Total external liabilities	3,171	3,825	4,214

a/ Excluding Canada.

b/ Including dependencies of European countries.

c/ Comprising bankers' liabilities less assets, and funds held in the United Kingdom as cover for overseas currencies, etc., but not including private holdings of securities, etc.

Notes on particular items in Tables 1 and 2 as given in Cmd. 7099 are reprinted below.

Table 1.

1. Includes imports from United Kingdom stocks overseas and from the United States "pipeline" as arranged in the Lend-Lease settlement of December 1945, as well as imports for re-export. Imports recorded in the Trade Accounts c.i.f. were £921 million in 1938 and £1,298 million in 1946. These include shipping and insurance expenses and measure imports as they pass through the Customs. The f.o.b. figures in the table exclude shipping and insurance and measure imports as payment is made for them.

1(e). Includes ships (£5 million in 1946).

2(a). Expenditure on forces overseas less receipts from overseas governments on war account, including arrears and sales of surplus stores.

(b). UNRRA and rehabilitation in Eastern Europe and the Far East, including advances to devastated countries.

(c). Cost of supplies for the British zone of Germany including exports from the United Kingdom (£20 million), less proceeds of German exports.

3. Partly estimated; comprises disbursements of United Kingdom ships abroad, freight and charter of foreign vessels and payments for British passengers in foreign ships. Excludes tankers.

10. Exports and re-exports as recorded in the Trade Accounts f.o.b. were £962 million in 1946. The figure in the table is an estimate of actual receipts from exports, which fall behind recorded shipments when these are increasing.

11. Partly estimated; comprises income from the carriage of United Kingdom exports and from cross-trades, expenditure of foreign vessels in the United Kingdom and receipts from foreign passengers in British ships.

12. Excludes insurance, shipping, and oil.

13. Includes, inter alia, net overseas earnings on oil and tankers, and an allowance for errors and omissions on current account. Items not specifically entered among payments are offset against various miscellaneous receipts in this item. Comparison between 1938 and 1946 is therefore precarious.

Table 2.

19. So far as ascertained.

20. Includes an allowance for errors and omissions on capital account.

Note on Monetary Developments in Peru, 1939-46

D.L.G. and F.G.N.

The money supply^{1/} in Peru increased from 285 million soles at the end of 1939 to 1,247 million soles on September 4, 1946 (latest data available), an increase of 338 per cent. (See table.) Although the growth in the money supply of most Latin American countries during this period was largely the result of monetization of abnormal surpluses in their balance of payments, this was not the experience of Peru. Of the above-mentioned increase in the Peruvian money supply, nearly nine-tenths had its origin in domestic credit expansion and only the small remainder had its origin in the acquisition of international reserves by the banking system. On September 4, 1946, only 12 per cent of the Peruvian money supply was of international origin. (See table.) A relatively small outflow of currency could thus exhaust the international reserves of the country. This would be an imminent danger were it not for the existence of a system of exchange control, which was introduced in January 1945.

Both the Central Reserve Bank and the other banks greatly expanded credit during the period under discussion. An analysis of the credit operations of the Central Reserve Bank reveals that nearly all of the expansion in its credit operations took the form of loans to the Government, which relied heavily upon such borrowing to finance its budgetary deficits. Central Reserve Bank loans to the Government increased from 105 million soles^{2/} at the end of 1939 to 627 million on September 4, 1946. Loans of the Central Reserve Bank to other banks remained very small--34 million soles on September 4, 1946, as compared with 24 million at the end of 1939. The expenditure by the Government of the funds borrowed from the Central Reserve Bank increased the reserves of the commercial and savings banks and thereby made possible a huge secondary credit expansion by these institutions. Although the larger part of the credit operations of these banks were with the public, loans to the Government also registered a substantial absolute increase and a relative increase which even exceeded that of loans to the public. Loans to the public rose from 229 million soles to 751 million, while loans to the Government rose from 51 million to 236 million.

The Central Reserve Bank of Peru therefore has been ineffective not only in preventing large-scale borrowing by the Government but also in preventing such borrowing from leading to an equally inflationary secondary expansion of credit by the other banks. The inflationary policies of the Government and the banks were reflected in the movements of the cost of living index which rose from 112 in 1939 (1934-36 = 100) to 224 at the end of August 1946, an increase of 100 per cent. At the end of January 1947, the index had risen an additional 18 points to a level of 242, which represented an increase of 116 per cent since 1939.

^{1/} Notes, coin, and checking deposits, excluding holdings of banks.

^{2/} A Peruvian sol is worth approximately 15 United States cents.

Money Supply of Peru
(In millions of soles)

<u>End of:</u>	<u>Total money supply</u> (1=2+3)	<u>Of international origin^{a/}</u> (2)	<u>Of domestic origin^{b/}</u> (3)
Dec. 1939	284.8	41.3	243.5
" 1940	343.6	46.7	296.9
" 1941	443.3	58.0	385.3
" 1942	611.1	134.8	476.3
" 1943	759.4	160.4	599.0
" 1944	930.3	136.2	794.1
" 1945	1060.7	144.5	916.2
June 1946	1130.6	108.3	1022.3
Sept. 4, 1946	1246.5	143.9	1102.6

a/ Created by the net acquisition of international assets by the banking system.

b/ Created by bank credit operations.

Exchange Control in Italy - II

Albert O. Hirschman

A previous article in this Review^{1/} has dealt with the system which permits Italian exporters to utilize or sell in the free market 50 per cent of their free exchange proceeds. The present note will analyze another feature--or regulated loophole--of the Italian exchange control: the system of the so-called "franco valuta imports". To purchase franco valuta means to import without asking the Exchange Control authorities for foreign exchange (and to enter a firm commitment not to do so once the commodities have been imported). This is, of course, possible only if the imports are matched against a transfer of capital (or a gift) from abroad. Except insofar as they are financed directly through credits granted by foreign exporters, franco valuta imports are therefore merely a variety, or an extension, of the concept of trade carried on through private barter or compensation. Although recent legislation has drastically curtailed the system, it remains an interesting episode in the history of exchange control.

Franco valuta imports were authorized early in 1946, largely, as in the case of the 50 per cent system, upon the urgings of the Convention of Foreign Trade held in Milan in March 1946. Detailed regulation started in April. A list, identical with list A of the 50 per cent system,^{2/} detailed the commodities importable upon the sole commitment not to ask for foreign exchange, while the importation of other commodities required

^{1/} March 11, 1947.

^{2/} See loc. cit., page 11.

an import license in addition. Franco valuta imports were authorized only from free currency countries; this restriction excluded Continental European countries with which payments agreements had been concluded. The "free" list was amended subsequently, one of the most important changes being the permission, granted as of July 1, 1946, to import coffee and cocoa franco valuta without ministerial license.

Subsequent legislation has gradually and severely restricted the system. On September 6, 1946, it was decreed that, in addition to the commitment not to ask for foreign exchange, proof was required that the imports were financed in one of three specified ways:

(a) Through transfer of capital from foreigners or Italians residing abroad. In this case, the importer paid the amount in lire due into an untransferable account in the name of the foreign resident, this account being subject to restrictive rules with respect to types and amount of expenditures authorized.

(b) Through repatriation of Italian holdings abroad which were not subject to surrender to the Government or which were subject to such surrender but were accumulated before March 26, 1946 (the date of the inauguration of the 50 per cent system). The latter undeclared holdings were to be repatriated through franco valuta imports within six months and for this purpose were granted immunity from penalties for failure to declare and surrender them. The time-limit for this immunity has since been extended another six months, i.e., to September 6, 1947.

(c) Through gifts from abroad.

Finally, on February 21, 1947, all franco valuta imports against transfers of foreign capital [(a) above] were prohibited since it was held that the extension of the 50 per cent system to foreign investments, which had taken place in January, provided foreign capitalists with a sufficiently attractive rate.

As is generally true with respect to private compensations, the rates of exchange at which the franco valuta imports are financed are different for each transaction. All that can be said in this respect is that prices quoted in Italy for many commodities such as coffee and cocoa permitted an importer to pay a rate of exchange of 800 lire to the dollar and still make a handsome profit. In general, the rates at which the franco valuta transactions have taken place are believed to have exceeded the black market rates for dollar bank notes by a margin of about 150 lire. As to the importance of the transactions, various estimates have put them at as much as 15 per cent of commercial imports in terms of lire and at between \$10 and \$20 million during 1946.^{1/}

^{1/} Because of the high rates of exchange applied, franco valuta imports occupy a larger share in total lire imports than in total dollar imports.

Interaction between the 50 per cent and the franco valuta systems has been evident in several respects. A commodity which could be imported by means of the free foreign exchange earned by exporters naturally would not be imported at the higher franco valuta rates. For this reason, the list of commodities freely importable through the franco valuta system and list A of commodities freely importable by means of free export currencies, which were identical at first, gradually had to be separated; while certain commodities were added to the former, the scope of the latter list became more restricted. Little is known as to the practices followed in issuing import licenses to the two categories of importers, but it appears likely that importers who could avail themselves of the franco valuta mechanism have been given preferential treatment. Every restriction of franco valuta imports has caused a tension in the free export rates since demand that was previously satisfied through the franco valuta system was forced to enter the bidding for the available free export currencies.

There has been much discussion of the merits and demerits of the system of franco valuta imports. Its partisans have pointed out

- (1) that it provided the many Italians who had violated the exchange control regulations in the 'thirties with a convenient method of repatriating their foreign resources which generally were held under the names of foreigners residing abroad;
- (2) that it made possible some influx of foreign capital without the actual establishment of a preferential rate of exchange for capital imports; and
- (3) that the repatriation of Italian foreign holdings and the influx of foreign capital would never have taken place at all at the low official rate of 225 to the dollar. Therefore, the imports made possible by these transfers represented a net addition to the amount of goods available in Italy even though they might not have corresponded to the Government's idea of what was most needed by the Italian economy.

The opponents of the system pointed out that the system worked not only as an amnesty for past violations of exchange control, but even more as an encouragement to new violations.

(1) Exporters have been reported to have undervalued their products and to have repatriated foreign holdings thus acquired through franco valuta imports.

(2) Purchasers of bank notes in the foreign exchange black market apparently have found it profitable to ship the notes acquired to their countries of origin and to reconvert them into lire or into imported merchandise through the system. In general, capital flight may have been encouraged by the certainty given to would-be exporters of capital that they could repatriate,

through franco valuta imports, their foreign holdings at a profitable rate of exchange and whenever convenient.^{1/}

(3) The most important source of the franco valuta transactions is said to have been purchases by Americans of real estate or business interests in Italy against dollar credits in the United States (Il Sole, March 8, 1947) which are then transferred through the franco valuta system. This practice deprived the State of valuable foreign resources.

(4) Furthermore, the system discriminated against the Italian emigrant and his family in Italy since, because of the small amounts sent and because of lack of business connections, he could not but transmit funds at the unfavorable official rate. One of the main purposes of the recent extension of the 50 per cent system and the concomitant restriction of franco valuta imports was to do away with this iniquity.

In general, it was pointed out, the imports which have taken place through the system were chiefly certain eagerly sought consumption goods of a semi-luxury character; the system therefore has catered to the few rich and possibly increased the internal stresses afflicting Italian society.

All in all, it seems that the system may have served a useful purpose in the beginning as a temporary amnesty for exchange control violators during Fascism and as a means of reestablishing Italian foreign trade connections. But its usefulness would appear to have come largely to an end, and its harmful aspects have gradually outweighed its possible benefits. Recent restrictive legislation will practically terminate the system by September of this year. It remains to be seen, however, whether the plea of the latest Convention of Foreign Trade, just concluded at Milan, to abolish that legislation and to reauthorize franco valuta imports on a more liberal basis will be heeded by the Italian Government.

^{1/} The counter-argument is, of course, that as long as general political and economic instability makes some measure of capital flight almost unavoidable, it is essential to provide some built-in mechanism through which the capital can be repatriated--whenever one particular cause for alarm to capitalists has ceased to operate.

Quadripartite Report on Germany

J. Herbert Furth

In February 1947, the Allied Control Council for Germany approved a report to the Council of Foreign Ministers, which among many other topics discusses economic problems (Section IV) and reparations (Section V). The report discloses some data for 1946, previously available only for the American and British zones of occupation, and at the same time reveals many of the basic difficulties hampering the work of the occupying powers. Mutual recriminations occupy about as much space as factual reporting, and considerably more than agreed recommendations.

Industrial Production

The French delegation stated that production in the Saar in 1946 reached 55 per cent of 1938, mainly because of the satisfactory level of output of the Saar coal mines. It gave no overall figure for the rest of the French zone, but reports from other sources indicate that industrial activity in the whole French zone was somewhat lower than in the other Western zones of occupation.

The Russian delegation, on the other hand, gave much production data, showing industrial activity ranging from 15 per cent of retained capacity for calcium carbide to 150 per cent for chlorine. Production of electric power was 120 per cent, cloth 85 per cent, shoes 70 per cent, and steel 45 per cent of retained capacity. The delegation did not indicate, however, what proportion of the output was allowed to be used for the German economy.

Allocation among the various zones of occupation of capacity for basic industries retained under the level-of-industry plan, and total German production in per cent of that capacity, are shown in Table 1.

Table 1
Allocation of Permitted Capacity of Basic Industries by Zones
and Actual Production, 1946
(Millions of reichsmarks at 1938 prices, except as noted)

Industry	Permitted Capacity	U.S. Zone	Allocation			USSR Zone	Production (as per cent of capacity)
			U.K. Zone	French Zone			
Steel ^{1/}	7,500	300	5,600	1,210	390	40	
Heavy engineering	432	75	254	28	75	60	
Light engineering	1,145	311	425	126	283	74	
Precision instr.	340	96	54	60	130	82	
Electrical eng.	1,500	414	564	148	374	52	
Basic chemicals	368	90	126	40	112	47	
Pharmaceut. chem.	332	49	169	33	81	84	
Dyestuffs	158	55	60	25	18	29	
Trucks ^{2/}	40,000	17,000	21,000	2,000	-	34	
Freight cars ^{2/}	30,000	6,200	12,400	4,200	7,200	4	
Cotton yarn ^{1/}	367	-	-	-	-	42	
Shoes ^{3/}	113	-	-	-	-	38	

^{1/} Thousands of metric tons.

^{2/} Units.

^{3/} Millions of pairs.

Coal production reached a hard-coal (Steinkohle) equivalent of 115 million metric tons, around 40 million tons short of the goal. The British zone produced 70 million tons, the American 2 million, the French 8 million, and the Russian 35 million (mainly in the form of lignite). The total output was about equal to the amount which under the level-of-industry plan should be available for domestic consumption.

Agricultural Production and Nutrition

The indigenous food production of Germany in 1946-47 yielded an average of 1,164 calories daily for non-self-suppliers, and was augmented by imports providing for an average of 482 calories, so that the total availability averaged 1,644 calories. Food production and deliveries in terms of volume is shown in Table 2.

Table 2
Food Production and Deliveries, 1946-47
(Thousands of metric tons)

<u>Commodity</u>	<u>Production</u>	<u>Deliveries</u>
Bread grains	6,070	3,813
Feed grains	4,709	1,148
Potatoes	24,903	11,157
Sugar beets	964	915
Meat (slaughtered weight)	1,001	787
Fish	256	256
Oil seeds	37	24
Milk	16,935	12,983
Butter	288	263
Cheese	151	139
Animal fats	78	41
Eggs (millions of eggs)	2,538	1,091

Food imports were valued at \$437 million, of which \$138 million went to the American, \$222 million to the British, and \$77 million to the French zone. Volume and value of imports according to commodities are shown in Table 3.

Table 3
Food Imports, 1946-47

<u>Commodity</u>	<u>Volume</u> (Thousands of metric tons)	<u>Value</u> (Millions of dollars)
Bread grains	2,498	281
Feed grains	70	6
Flour	319	44
Potatoes	493	24
Meat and fats	6	2
Fish	178	24
Sugar	35	8
Milk	260	13
Other	309	35
Total	4,168	437

Total food availabilities in terms of calories, broken down according to zones of occupation, is shown in Table 4.

Table 4
Food Availability by Zones, 1946-47
 (Calories daily per non-self-supplier)

	<u>U.S.</u> <u>Zone</u>	<u>U.K.</u> <u>Zone</u>	<u>French</u> <u>Zone</u>	<u>USSR</u> <u>Zone</u>
Deliveries from domestic production:				
Cereals	532	381	352	964
Potatoes	231	181	296	331
Meat and fish	87	82	20	42
Milk	181	173	145	101
Sugar	32	92	50	141
Other	28	22	-	26
Total	1,091	931	863	1,605
Imports	569	723	863	1
Grand total	1,660	1,654	1,726	1,606

These data show that food supplies for non-self-supporters were most plentiful in the French, and least plentiful in the Soviet zone. The French data, however, appear to be somewhat exaggerated, perhaps because of inadequate consideration of the amount of domestic food consumed by the French forces of occupation; according to other reports, the food situation in the French zone is as bad as in the Russian zone. On the average of all zones, the daily caloric intake per head is lower by about 560 calories or 25 per cent than the minimum standard accepted by the United Nations Food and Agricultural Organization, and by about 1,200 calories or 40 per cent than the German pre-war standard. The reduction took place mainly in the supply of protective foodstuffs, especially in the Russian zone where carbohydrates constituted about 90 per cent of the total caloric intake.

The deterioration in the food situation is primarily the result of the reductions in German land available for food production, and in crop yields. Germany has not only lost the fertile soil of the area east of the Oder-Neisse line, but even within its present borders only 89.4 per cent of the acreage tilled in 1938 was sown in 1946. With the exception of vegetables and oil seeds, all acreages showed drops, ranging from 17 per cent for feed grains to 6 per cent for sugar beets. The expected shift from feed to bread grains has hardly taken place so far; the acreage of bread grains actually decreased by 12.3 per cent. For 1947, however, it is planned to increase the total acreage sown to 112 per cent of 1938, and to raise the acreage of potatoes, sugar beets, and bread grains by more than the average at the expense of feed grains.

Crop yields per hectare averaged about 80 per cent of the 1934-38 level for potatoes, 75 per cent for grains, 70 per cent for sugar beets, and 50 per cent for oil and textile crops. In 1947, only small increases are expected. This drop is due to the inefficiency of labor, largely resulting from depressed standards of living and absence of incentives for greater efforts; the disorganization accompanying the dissolution of large estates in the Soviet zone; the scarcity of machinery; and the lack of fertilizer. Supplies of nitrogen fertilizers averaged 22 per cent, of phosphates 6 per cent, and of potash--in pre-war days an important export commodity--37 per cent of requirements. The situation was made worse by the maldistribution of existing supplies among the various zones; in the

American zone, the proportion of supplies of nitrogen and potash to requirements was about equal to the average for all of Germany, but the supply of phosphates reached only 1.5 per cent of requirements; in the French zone, nitrogen covered 46.5 per cent of requirements, but potash only 1 per cent; in the Russian zone, potash actually exceeded requirements by a slight margin. Obviously an exchange of potash for nitrogen between the Russian and French zones would be highly advantageous to both areas.

Livestock decreased less sharply than might have been expected, with horses virtually at the pre-war level, and cattle only about 12 per cent lower. Pigs, however, were at 45 per cent, and poultry at 50 per cent of 1938. For 1947, a further decline in pigs, but an increase in poultry by around 15 per cent has been planned, with little change in the horse and cattle population.

The problem of land reform has been solved drastically in the Soviet zone where 2.1 million out of 3.8 million hectares of estates with 100 hectares or more were situated. In the American and French zones, the acreage of large estates is small, but in the British zone it amounts to 1.2 million hectares. The breakdown of large estates in the Western zones is expected to be started in the near future. It is highly doubtful, however, whether--as the Soviet delegation maintains--land reform will result in higher crop yields.

Trade and Transportation

Data on interzonal trade are incomplete and contradictory. The British delegation presented only tonnage figures. The other delegations gave value data calculated in reichsmarks at 1938 prices, but the American data covered only the second and third quarters of 1946. Even the data of the French and Russian delegations, purported to be calculated on identical bases and for identical periods, showed remarkable differences: trade between the French and Russian zones showed a Russian export surplus of 4 million marks according to Russian, and a French export surplus of 6 million marks according to French figures. Taking the trade volume of the American zone for all of 1946 as approximately twice the figure shown for the second and third quarters,^{1/} trade between the American and French zones resulted in an American export surplus of 85 million marks according to the American, but of only 19 million according to the French figures. Trade between the American and Russian zones showed an American export surplus of 44 million marks according to the American, but a Russian export surplus of 1 million according to the Russian figures; on the basis of the American calculation, exports from the American to the Russian zone in the second and third quarter alone were larger by 70 per cent than those shipments during the entire year on the basis of the Russian calculation. It seems clear, however, that the contribution of the Russian zone to total interzonal trade was very small indeed. The figures provided by the various delegations are compared in Table 5.

^{1/} Interzonal trade increased regularly after the beginning of the year so that the sum of second and third quarter figures probably was not very different from the sum of first and fourth quarter figures.

Table 5
Interzonal Trade, 1946
 (Millions of reichsmarks at 1938 prices)

	<u>Importing Zone</u>		<u>Exporting Zone</u>			
	<u>Total</u>		<u>U.S. Zone</u>	<u>U.K. Zone</u>	<u>French Zone</u>	<u>USSR Zone</u>
U.S. Zone	385 ^{a/} - 580 ^{b/c/}		-	264 ^{a/}	96 ^{a/} - 295 ^{b/}	21 ^{c/} - 25 ^{a/}
U.K. Zone	525		307 ^{a/}	-	153 ^{b/}	65 ^{c/}
French Zone	392 ^{a/c/} - 524 ^{b/}	181 ^{a/} - 314 ^{b/}		205 ^{b/}	-	6 ^{c/} - 7 ^{b/}
USSR Zone	86 ^{c/} - 146 ^{a/b/}	20 ^{c/} - 69 ^{a/}		64 ^{c/}	2 ^{c/} - 13 ^{b/}	-
	<u>1,520 - 1,643 d/</u>	<u>557^{a/} - 641^{b/c/}</u>		<u>533</u>	<u>251^{a/c/} - 461^{b/}</u>	<u>92^{c/} - 97^{a/b/}</u>

a/ Approximately twice U.S. figure for second and third quarters, 1946. (See footnote 1 on the preceding page.)

b/ French figure.

c/ Russian figure.

d/ The limits are the sums of the figures presented by each delegation for its own zone, and of the figures calculated from the data for the other zones, respectively.

The shrinkage of German domestic trade in relation to pre-war years is apparent from the figures on transportation. Total freight carried by railways, inland waterways, coastal shipping, and highway traffic was around 250 million metric tons, as compared to 582 million tons carried by railways and inland waterways alone in 1937. Actually, the decrease is still sharper than indicated by these figures since in 1946 interzonal traffic was counted separately in each zone. Railways accounted for around three-fourths of the 1946 total; it was around 40 per cent of the 1937 level--neglecting the inaccuracy due to interzonal duplication--, while inland waterway traffic was only around 20 per cent of pre-war. According to statements of the American and British delegations, the Soviet Union contributed to the traffic difficulties by removing railroad tracks and transportation equipment from the Russian zone.

Figures on foreign trade were not made available because the Soviet delegation refused to inform the Council of the amount of reparation exports.

Finance

Figures on occupation costs were not made available because the Soviet delegation refused to inform the Council of the amount charged to the budgets of the German states on that account. All delegations reported, however, that "internal" occupation costs (wages and salaries paid in German currency and compensation for German goods and services) were charged to the budgets of the German states situated in the corresponding zone of occupation and that the issue of military marks had stopped. "External" occupation costs (troop pay and other expenses in the currency of the occupying power) were financed by the occupying powers.

In the field of banking, the Western occupying powers permitted free use of deposits, except for those blocked for reasons of denazification and demilitarization, and free interzonal transfer except to and from the Soviet zone. In the Soviet zone, all pre-occupation deposits remained blocked (except for a sum of 400 marks) and transfers from post-occupation accounts to other zones were permitted only for authorized payments, especially for authorized imports of goods. Moreover, in the Soviet zone all pre-occupation banks were closed and their entire personnel dismissed, "thus"---in the words of the Soviet delegation--- "radically solving the problem of denazification", and new banks established, including 5 provincial banks, 565 city and district banks, 2,515 savings banks, 2,955 agricultural credit cooperatives, 271 urban credit cooperatives, and 11 small private banks. All transactions in pre-occupation securities were prohibited and the stock exchanges closed, "in order to undermine the power of banking and industrial monopolies". According to the statement of the American delegation, however, the anti-inflationary measures taken by the Soviet authorities as well as by the other occupying powers were made substantially less effective by the fact that the Soviet authorities indulged in the large-scale issue of military marks and, contrary to agreement, refused to report the amount of that issue.

In the Western zones, all banking institutions had to sever their connection with agencies situated outside of their zones, and especially with central offices located in Berlin. Total assets of all banks on June 30, 1946, amounted to 209 billion marks, including 17 billion in assets of the newly established banks in the Soviet zone; this figure compares with assets of all German credit institutions totalling 95 billion reichsmarks at the end of 1938, and 323 billion at the end of 1943. The decline from 1943 was due entirely to the disappearance of the pre-occupation banks in Berlin and the Soviet zone of occupation. In the Western zones, bank deposits increased (in the American zone by as much as 75 per cent between the beginning of the occupation and the end of 1946), but the inflowing currency was kept in cash or with other financial institutions because of the lack of investment opportunities. About 40 per cent of all bank assets in the Western zones consisted of Treasury bills or other government securities of the former Reich. A summary of the statements of all banks, by types of assets and liabilities and by zones, is shown in Table 6.

Data on currency circulation could not be presented due to the refusal of the Soviet delegation to disclose the amount of military marks issued in the Soviet zone. According to the statement of the American delegation, this failure prevents the effective control of the currency in all of Germany.

Table 6
Summary of Bank Statements, June 30, 1946
 (Billions of reichsmarks)

	<u>U.S.</u> <u>Zone</u>	<u>U.K.</u> <u>Zone</u>	<u>French</u> <u>Zone</u>	<u>USSR</u> <u>Zone</u>	<u>Total</u>
<u>Assets</u>					
Cash and "giro" balances	12	15	3	10	40
Claims against other banks	13	21	5	6	43
Treasury bills	18	17	1	-	36
Other securities	13	21	5	-	40
Commercial bills and advances	9	14	2	1	25
Mortgage and municip. loans	5	5	*	-	10
Other assets	4	10	*	1	14
Total	75	101	17	17	209
<u>Liabilities</u>					
Saving deposits	21	35	11	*	67
Other deposits	46	59	6	12	124
Other liabilities	6	4	*	4	14
Capital and reserves	3	2	*	*	4
Total	75	101	17	17	209

Note: Due to rounding, totals do not necessarily check.

*Less than 0.5 billion.

In the field of international finance, the Council agreed that all payments for exports from Germany should be made in dollars or other currencies acceptable to the Council, except in cases where the zone commander assumes responsibility for converting the payments in full into currencies acceptable to the Council, or for compensating them with payments for approved imports. The Soviet delegation reported, however, that exports from the Soviet zone to Russia are "at the present time" not paid for in foreign currency, and that "special accounting takes place for these deliveries". The American and British delegations insisted that because of the failure of the other occupying powers to implement the agreed economic unification of Germany, payment in dollars also had to be made for balances resulting from interzonal trade--a position strongly protested by the Soviet and French delegations.

Payments due to released prisoners of war under the Geneva Convention were converted into marks at the rate of 15 marks per pound by the British authorities, on the basis of an agreement concluded at the beginning of the war with the former Reich government, and at the rate of 30 United States cents per mark by the American authorities, in order--as the American delegation stated--"to give a true relationship to the purchasing power of the two currencies in the official domestic markets".

Reparations

In the Western zones, 738 plants were approved for valuation as reparations, and 136 of them were actually allocated up to the end of 1946.

The approved plants include 202 aircraft factories, 210 armaments and munitions firms, 173 mechanical and metal working enterprises, 35 power plants, 29 shipbuilding enterprises, 49 chemical factories, and 40 firms producing building materials (mainly cement). The valuation of an additional 808 plants is in the process of revision. In terms of volume, 316,000 tons of material has been allocated and 106,000 tons actually shipped. The Soviet Union was allocated 236,000 tons, Yugoslavia 27,000 tons, France 17,000 tons, and Czechoslovakia 9,000 tons, while no other country was allocated more than 5,000 tons. This distribution seems to indicate that the Council favored the Soviet Union and its satellites at the expense of the Western powers. Nevertheless, the Soviet delegation criticized the reparation procedures violently, alleging that one-third of the plants designated for reparations was virtually worthless, that the most modern plants were excluded from valuation, and that about thirty times the amount actually loaded should have been shipped to the reparation creditors. The French delegation also criticized the Council for the slowness of removals and an alleged bias in favor of Germany, which subordinated the requirements of the reparation creditors to those of the German economy. It is true that judging from fragmentary data presented by the American delegation the allocated equipment was worth hardly more than 200 million marks at 1938 prices, or an estimated \$120-140 million at present prices, so that reparation shipments had little effect on the needs of reparation creditors.

On the other hand, the American delegation complained that the Soviet element was withholding information on reparations from the Russian zone, and stated that no further allocations or shipments from the American zone would be made, with the exception of agreed "advance reparations" and removal of actual war plants, as long as the Soviet element refused to honor the agreements on reciprocal deliveries,^{1/} the economic unification of Germany, and the information on reparations from the Russian zone. It also declared that the reparation plan of 1946 needed to be amended in the light of the future of the Saar and several inconsistencies contained in the level-of-industry plan. All three Western powers complained that the Soviet element had not yet started reciprocal deliveries and asked that these deliveries be provided from sources outside Germany or from such German goods as would be in excess of requirements according to the agreed minimum level of the entire German economy.

Economic Policy

The harm done to the German economy by the economic separation of the zones of occupation is indicated by a table showing the distribution of economic resources among the various zones. A summary of the data presented is included in Table 7.

^{1/} Reciprocal deliveries are specified shipments to be made by the Soviet Union under the Potsdam Agreement in return for the Russian share in reparations from the Western zones.

Table 7
Distribution of Economic Resources by Zones
 (Per cent of total, excluding Berlin)

	<u>U.S.</u> <u>Zone</u>	<u>U.K.</u> <u>Zone</u>	<u>French</u> <u>Zone</u>	<u>USSR</u> <u>Zone</u>
Population (1946)	26.5	36.4	9.5	27.6
Arable land (1946)	26.3	27.8	8.9	37.0
Woods (1946)	30.2	26.0	12.8	31.0
Cattle (1946)	37.8	30.3	12.3	19.6
Hard coal production (1936)	-	88.5	9.3	2.2
Lignite production (1936)	1.5	33.0	-	65.5
Electric power production (1939)	16.6	42.4	8.8	32.2
Steel production (1939)	4.1	74.4	16.2	5.3
Heavy engineering (1939)	17.3	38.8	6.6	17.3
Light engineering (1939)	26.7	37.5	11.0	24.8
Cement production (1939)	27.5	49.5	10.5	12.5
Artificial fibers (1939)	32.0	60.4	7.6	-
Spinning mills (1939)	20.5	39.0	13.0	27.5
Weaving mills (1939)	16.4	63.1	12.0	8.5
Shoe production (1939)	30.2	16.8	33.6	19.4

The interdependence of the zonal economies is indicated also by figures produced by the Soviet delegation and showing the distribution of Germany's foreign trade of 1939 according to the area of the present zones of occupation. A summary of these figures is included in Table 8.

Table 8
German Foreign Trade (1939) by Zones
 (Millions of reichsmarks)

	<u>U.S.</u> <u>Zone</u>	<u>U.K.</u> <u>Zone</u>	<u>French</u> <u>Zone</u>	<u>USSR</u> <u>Zone</u>
<u>Exports</u>				
Steel	45	632	41	31
Coal	4	281	30	5
Chemicals	115	247	82	125
Machinery	237	375	145	357
Textiles and footwear	68	132	26	106
Other commodities	214	446	26	266
Total	683	2,113	350	890
<u>Imports</u>				
Food	318	529	162	380
Raw materials	243	406	123	292
Other commodities	207	344	105	247
Total	768	1,279	390	919
Excess of exports (+) or imports (-)	-85	+834	-40	-29

These figures show that all zones except the British had an import surplus, but that the export surplus from the British zone was more than sufficient to offset the import surplus of all other zones combined.

The American delegation felt it necessary to insist on every occasion upon the implementation of the Potsdam Agreement on the economic unification of Germany. The Soviet delegation in turn contended that the merger of the American and British zones would lead to the political and economic division of Germany, and that for this reason the Russian zone refused to join in that merger.

The American and British delegations stated that Russian authorities had forced the removal of coal, sugar, textile, and other industrial equipment from the Russian zone, contrary to the agreed plan according to which those peaceful industries were to be encouraged rather than curtailed. At the same time, the Soviet authorities had retained war industries in excess of agreed capacities, for instance in the field of heavy machinery (228 per cent) and chemicals (260 per cent). The British delegation also pointed out some inadequacies in the level-of-industry plan, especially in the field of building materials and engineering. Both delegations repeatedly declared the need for correcting the level-of-industry plan. On the other hand, the French delegation took the position that the whole of German industry constituted a basic element of Germany's war potential, and therefore was opposed to changes in favor of Germany.

The disagreement became particularly apparent in the matter of decartellization. The British delegation was in favor of a very cautious approach to the subject. The American delegation deplored the lack of quadripartite anti-monopoly actions; it also complained that the Soviet authorities had taken over the largest industrial plants in the Soviet zone, including some 200 enterprises with a productive capacity of 25 or 30 per cent of the entire zone, and thus had created an organization embodying an excessive concentration of economic power.

Wide divergences of opinion among the occupying powers also arose in connection with matters discussed in previous sections of the present paper, especially in the field of currency reform, banking organization, interzonal and foreign trade, and reparations. The resulting conflicts, which were reflected in numerous "unilateral statements" of the delegations of the occupying powers, foreshadowed the outcome of the Moscow Conference.

Russian Industry in the First Quarter of 1947

A.G.

The report of the Gosplan on industrial developments during the first quarter of 1947 supplies--and withholds--much the same type of information as did the preceding report for 1946.^{1/} The figures reveal that the degree of fulfillment of the Plan was considerably less satisfactory in the first three months of 1947 than was the case for the whole year 1946. In the more recent period only very few branches exceeded their targets, while the majority showed considerable lags. The latter category includes ferrous metals and coal, production of which remained behind the Plan goals by 8 and 6 per cent,^{2/} respectively.

The rate of increase of output in these branches was very much below the scheduled annual rate of increase for 1947. The planned average increase in 1947 over 1946 is 21 per cent for pig iron, 19 per cent for steel, and 16 per cent for coal. But the rate of increase in the first quarter of 1947 over the first quarter of the preceding year was only 10 per cent for pig iron and 4 per cent for coal. Significantly, no figure for steel (except for the rolled product) is given. This omission is very unusual indeed and suggests strongly that steel output actually declined rather than increased in the first three months of 1947 as against the same period in 1946.

The lag in output of basic industrial raw materials is doubtless one of the most crucial problems of the Russian economy. Even if the targets of the current Five Year Plan are reached, the scarcity of basic industrial materials will continue to be a seriously retarding factor. The specific reasons for the poor performance shown during the first quarter are not easy to determine. The communique of the Gosplan mentions the severity of the past winter. Weather conditions are said to have affected transportation so that car loadings remained on the level of the first quarter of 1946. This is more likely to explain the lag in the output of ferrous metals than in that of coal. The poor physical condition of industrial labor may have been a contributing factor. Complaints about the low level of productivity were rife in Russia several months ago. Yet such complaints have recently all but disappeared from the pages of the daily press, and it seems that a critical situation in this respect has been successfully overcome, at least for the time being. This was achieved in part by upward adjustments in the planned output of articles of mass consumption. It should also be noted that, on the whole, in the first quarter of 1947 consumers' goods industries show both a somewhat higher degree of fulfillment of the Plan and a higher percentage increase in output in relation to the first quarter of the preceding year than do the heavy industries. Travellers' reports likewise suggest some improvement in the supply situation, particularly of textile goods. It has been reported that an attempt is being made to fulfill the consumers' goods portion of the Plan by the beginning of November 1947. Finally, the relatively poor harvest in fodder crops apparently has led to an increase in the slaughter of livestock, and thus provided a temporary improvement of the diet during the winter.

^{1/} See this Review, March 25, 1947.

^{2/} Western coal; coal output in the East lagged three per cent behind the Plan.

This alleviation of the consumption and productivity situation does not mean, however, that occurrence of a new crisis is altogether unlikely. Agriculture may well play a strategic role in this respect. Industry has so far failed to make a serious contribution to agricultural recovery, and this failure may in turn prove a serious obstacle to industrial expansion. A recent official report revealed very considerable declines in agricultural output as compared with pre-war. An example may be cited here to illustrate how inadequate is the help which agriculture is receiving from industry at present. According to a recent decree, in 1947 agriculture is expected to obtain 30,000 tractors. To appraise this figure, it may be recalled that 530,000 tractors were used in agriculture in 1940. The average lifetime of the much over-worked Russian tractor is about six years, which means yearly replacement requirements of some 85,000-90,000 tractors. Since the number of tractors available to agriculture undoubtedly has been greatly reduced during the war, the planned supply of 30,000 tractors may be regarded as negligible. This does not augur well for the recovery of agricultural production. Undue lags in the rehabilitation of agriculture, however, are likely to affect industry not only directly through inadequate supplies of raw materials, but also indirectly through deficiencies in the diet of the urban workers.

There is little evidence that the Russians intend to forestall new difficulties in the field of agriculture by large-scale imports of tractors, as well as hides and skins, livestock and other agricultural products. The three large tractor factories which Russia had before the war are being reconverted to peace-time use and two additional large plants are being built. But the supply of tractors will not reach significant proportions before 1949. While it is in keeping with their traditional policy of self-sufficiency for the Russians to accept temporary shortages rather than to have recourse to imports, a situation may arise in which the latter will become indispensable.