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REVIEW OF FOREIGN DEVELOPMENTS

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European Payments Union - A Possible Basis for Agreement
By Albert O. Hirschman 8 pages

The Double Price System in Czechoslovakia
By Gregory Grossman 6 pages

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EUROPEAN PAYMENTS UNION - A POSSIBLE BASIS FOR AGREEMENT

Albert O. Hirschman

Both the Economic Cooperation Administration and the Organization for European Economic Cooperation have recently concentrated considerable effort on the elaboration of a plan to make European currencies transferable among each other. Since the spring of 1949, the OEEC has made a series of attempts to break down directly the barriers to a freer intra-European flow of goods and services. Increasingly, however, it was felt that the existing bilateral pattern of intra-European payments, which in general does not permit a country to offset a deficit in one direction by a surplus in another, bears a share of responsibility for the continuance of many trade restrictions. Mainly for this reason, the move toward a progressive elimination of quantitative restrictions in intra-European trade would be considerably strengthened by a payments system providing for multilateral compensation of balances within the European area. The ECA attaches considerable importance to the establishment of such a system, in substitution for the current, essentially bilateral Intra-European Payments Scheme, and is ready to supply its hard-currency needs by setting aside a substantial portion of the 1950/51 appropriation for this purpose.

Plans for such a system, known as a European Payments Union, were discussed early this year in technical committees of the OEEC with the active participation of the ECA. Considerable progress was made in spelling out the principal issues on which agreement had to be reached before a workable plan could be devised. During the January session of the OEEC Council, however, the British Chancellor of the Exchequer voiced a number of important doubts and reservations with respect to the proposal. 1/ A measure of agreement on basic principles of a European Payments Union was reached eventually and was incorporated into the Second Interim Report of the OEEC. 2/ Nevertheless, considerable difficulties remain in devising a plan that will be acceptable to all interested parties.

The following paper attempts to set forth some of the issues that are still sources of difficulty in reaching any general agreement, and speculates as to possible ways in which these difficulties might be resolved. Although the discussion around the European Payments Union is many-cornered and although the points of view of the United Kingdom and of the United States are by no means the two that are farthest apart, the writer finds it helpful to start out by listing the basic conditions which the British and the U. S. Governments are likely to attach to any such agreement.

1/ OEEC Council, European Payments Union, Memorandum by the Chancellor of the Exchequer of the United Kingdom, Paris, January 27, 1950, c(50)30 (restricted).
2/ Second Report of the OEEC, Paris 1950, pp. 224-232.

The U. S. Government will probably insist that the EPU fulfill the following requirements:

1. It must result in full and automatic multilateral clearing of balances, due regard being given to pre-existing obligations and claims between pairs of participating countries.
2. After exhaustion of multilateral drawing rights and of "swing" credit margins, net balances resulting from the clearing must be settled partly in gold, in order to avoid the formation of a high-cost, soft-currency area and in order to provide debtors with adequate incentives to avoid excessive imbalance.
3. Since the payments arrangements are useful only insofar as they contribute to a freer movement of trade in Europe, these arrangements must not lead to greater freedom to impose or strengthen restrictive measures than would exist without them.

The fundamental British reservations in connection with the payments union may be formulated as follows:

1. A European Payments Union cannot be permitted to interfere either with sterling's role as an international currency and or with its use as monetary reserve by a number of countries.
2. The Union should not increase the likelihood of gold and dollar losses by the U. K.
3. Whenever the clearing arrangement threatens to lead to substantial gold losses by the United Kingdom, the latter must be permitted to reintroduce any previously lifted quantitative restrictions.

From these two sets of principles a series of practical issues have arisen which may be catalogued in the following way:

1. Is the United Kingdom going to preserve its presently held right not to settle in gold or dollars any amounts of sterling accumulated by the European members of the transferable account area, such as Italy, Sweden, the Netherlands, etc?
2. What is going to happen to the sterling balances accumulated by the other European countries and held by them in the expectation that they are readily available for the financing of any import surplus with the sterling area?
3. How are transfers of sterling from the rest of the sterling area to Continental countries to be treated?
4. Under what conditions will it be permissible to combat gold losses to the Payments Union by the imposition of quantitative restrictions?

In the following we shall take up each question in turn and shall try to sketch answers which, taken together, might prove acceptable both to the United Kingdom and to the United States.

I. Ceiling on Credit Facilities Extended to the U. K. by the EPU Members as a Group

On this point the U. S. attitude is likely to be quite firm. Without an overall ceiling on credit facilities the U. K. could run import surpluses with countries like Italy which do not require any form of settlement, while possibly drawing gold from the EPU in settlement for credits earned with countries that do not hold sterling balances. In this way the EPU would become a one-way street for Britain. Multilateral compensation, insofar as the U. K. is concerned, would be severely limited and the system would contain no adequate incentives for Britain to avoid excessive imbalance, in fact there would be a premium on certain types of imbalance.

If it is to be more than an occasional member in compensation operations requiring the express approval of all affected parties, the U. K. ought, therefore, to be subject in this respect to the rules prevailing for all other members. Fractional gold payments should begin after exhaustion of a "swing" and of possible multilateral drawing rights granted to cover "structural" deficits. In the case of the U. K., there will be some question whether the swing should be calculated on the basis of the intra-European trade of the U. K. only or of the whole sterling area. A case may well be made for the latter and in this eventuality the swing accorded (and to be accorded by) the U. K., though limited, would be considerable. 1/

In what respect will the establishment of an overall "gold point" for the U. K. in its relations with the other EPU members as a group affect the use of sterling as an international currency? It is possible that, as a result of losing the unlimited overdraft facilities enjoyed so far with the European members of the transferable account area (Italy, Sweden, etc.), the U. K. will want to make these countries revert to bilateral account status. The only practical result of this action, however, would be to prevent the automatic transfer of sterling for current transactions from the few non-European members of the transferable account area (e.g. Egypt). It is unlikely, therefore, that such an action on the part of the U. K. would be very effective in stemming sterling accumulations by the European countries in question. We shall return later to the problems raised by transfers of sterling from the rest of the sterling area to the Continental members of the EPU. It is sufficient here to show that a restriction of the transferable account area would likely be either unnecessary or inadequate in dealing with the situation resulting from sterling accumulations by European countries which give rise to gold obligations on the part of the U. K. (The history of U. K. - Belgian payments relations sufficiently illustrates this point).

1/ In this connection, it would seem that an entirely unnecessary controversy has been created by the discussion around the funding or reimbursement of the "swing" credits. The U. K. position is correct in pointing out that yearly reimbursements of the swing credits in hard currency would be equivalent to the introduction of an only lightly veiled gold standard system. The swings under the EPU should be nothing but the multilateral counterpart of the bilateral overdraft facilities or agreements to hold each other's currency up to a certain absolute amount, but without specific time limit.

There is no doubt that the establishment of an overall ceiling on over-draft facilities might result in gold losses to the U. K. which it would not incur under present circumstances. This would mean, therefore, a violation of one of the basic conditions which the British have insisted upon. Any resulting British opposition to the Payments Union ought, however, to be neutralized by the arrangements with respect to existing intra-European sterling balances which are discussed in the next section.

II. Existing Sterling Balances

The problem of building the sterling balances accumulated by several European countries into the EPU mechanism affects both British interests and the interests of the countries that have accumulated sterling in the past years.

The problem permits two opposite solutions which appear equally unsatisfactory and impractical: One would be to require the United Kingdom and the European holders of sterling to freeze, fund, or settle somehow the existing sterling balances and to enter into the clearing union with a clean slate. Clearly, this would be unacceptable to the countries which are large-scale holders of sterling because such an arrangement would deprive them of their present ability to finance an import surplus with the sterling area. It would also be unacceptable to the United Kingdom which would be apprehensive over the loss of confidence in sterling that would result from such an arrangement.

At the other extreme, there is the possibility of allowing current holders of sterling to keep it as an "existing resource". In view of the size of some of the accumulations, such a course would be tantamount to the exclusion of sterling from the clearing mechanism to a considerable extent. Not only would it materially restrict the area of multilateral compensation, but it would also have quite inequitable results - for instance a country holding sterling balances could have an overall deficit with the other ERP countries and yet be entitled to gold payments from the European Payments Union if it had a credit toward the non-sterling countries along with a larger debit toward the sterling area.

A solution, lying somewhere in the middle between these two extremes could be found by transferring to the EPU sterling balances presently held by European Central Banks. As a result, countries that have accumulated sterling would acquire a corresponding credit position in their EPU account which would be matched by a debit of the United Kingdom's account. These credits and debits would be as fully multilateral as all EPU accounts. The U. K. could not object to this operation on the grounds that it would reduce the standing of sterling as an international currency. The transaction would, indeed, enhance the standing of sterling since the sterling balances held by European countries would have been converted into a more widely usable currency. Neither would the uses of sterling as an international currency be affected. Individual traders would continue to deal in sterling and any conversion of sterling into EPU credits would be exclusively reserved to Central Banks. The U. K. might, however, object to the operation both because its liability would be increased through multilateralization and, as already discussed, because of the end of the unlimited over-draft facilities previously enjoyed.

To obtain U. K. agreement a number of provisions entailing compensating advantages for the United Kingdom may be considered:

1. Since the transfer of sterling balances to the European Clearing Union would increase both the value of these balances to the holder, e.g. Italy, and the weight of the U. K.'s obligation resulting from them, it might be considered equitable to request from Italy, and to grant the U. K., a cancellation or a funding of a portion of the balances. The funding could take the form of setting up two EPU accounts, one of which would be currently available whereas the other would be blocked, for the U. K. and for Italy. The balances held in the blocked accounts would then be scheduled to pass into the current accounts in accordance with a pre-determined time schedule. However, there is no doubt that it will be extremely difficult to negotiate such agreements.

It is also conceivable to block, in the way just described, part of the U. K. debit while leaving Italy's credit untouched. Under these conditions, however, a full drawing down by Italy of its credit while part of the corresponding U. K. debit is blocked, would result in gold losses by the EPU and in credit extension by third EPU countries. In fact, such a development would mean a temporary taking over of part of the European sterling balances by the combined resources of the EPU and its members other than the U. K.

2. Alternatively, one might consider a simple device which would permit the U. K. to receive gold from the EPU before full reimbursement of the U. K.'s EPU debit. Let us assume that transfer of the sterling balances to the EPU would leave the U. K. with an intra-European debit balance of 100 while its normal "swing" margin would amount to 30 in each direction. Under those conditions the U. K. would have its "swing" margin on the debit side increased to 130, so that it would have to start making gold payments after having incurred an additional debit of 30. However, it could start receiving gold only after having accumulated intra-European credits in the amount of 130. To eliminate or reduce this asymmetry it could be decided that the U. K. is to receive partial gold payment for its intra-European credits after having accumulated European credits in an amount smaller than 130 (but not smaller than 30). From that point on, a U. K. export surplus with the EPU countries would serve only in part to reduce further the U. K. debit with the payments union; the balance would accrue to the U. K. in the form of gold.

Such a provision could no doubt result in gold losses to the EPU, but these losses could be limited by applying a converse provision to the holders of EPU credits originating in sterling balances. In other words, provision could be made for permitting the present holders of sterling balances to draw down only a portion of these balances during a given period. If their total debit position during a period is larger than this portion they might be required to make a partial gold payment for the excess and would draw down their credits with the EPU for the balance of the excess. 1/

1/It will be readily seen that the two devices discussed so far are essentially similar in their economic effects. It will probably be well to use either the one or the other but not the two in combination. It appears to the writer that the second device might be easier to negotiate.

3. Finally provision may be made for reducing or funding the U. K.'s indebtedness to the payments union whenever the credit position of the former holders of sterling balances is reduced, whether or not this reduction comes about as a result of an export surplus of the U. K. Under such a provision the U. K.'s debit resulting from the transfer of Italy's sterling balances would be scaled down in the event of, say, an Italian import surplus with Belgium.

The rationale for this action would be that, with such a development in Italy's trade, Italy's claim to receive a compensation for its past export surplus to the United Kingdom would have been satisfied. Under our assumptions, Belgium would become a creditor and would be entitled to some receipts of gold or dollars after exhaustion of its swing margin.

This device again would mean that part of the U. K.'s debit could be taken over jointly by the EPU and the resources of its non-U.K. members. The difference between this device and the one discussed under (1) above is merely that here the cancellation or funding of the U. K. debit would take place only if and when the development of trade has shown that the U. K. is not called upon to satisfy Italy's claim to an import surplus. While attractive on this ground, the proposal is beset with considerable technical difficulties. -

The above devices, used singly or in combination, should prove quite attractive to the United Kingdom for they would result in a reduction or a staggering of British liabilities and, under some combination of circumstances, in gold payments to the United Kingdom before full reimbursement of its present liabilities. All of these devices entail the possibility of gold losses to the EPU. 1/ But a contribution from ECA for this purpose might be highly constructive--possibly more so than the one originally contemplated with the purpose of bridging the gap between debtors' gold payments and creditors' gold receipts.

Further, the use of such devices would not constitute privileged treatment for the United Kingdom at the expense of others. We have seen that because of existing arrangements with respect to sterling the U. K., upon becoming a full-fledged member of the EPU, would definitely have to give up certain rights presently held and used. Therefore, arrangements such as those we have discussed above would not mean the granting of special new advantages, but merely a compensation for the loss of advantages currently enjoyed by the U. K.

1/ A simple transfer of sterling balances to the EPU, unaccompanied by any of the above provisions, could in itself lead to either larger gold losses or larger gold gains than would have to be sustained otherwise by the Union. Thus, if Belgium rather than the U. K. develops an export surplus toward Italy after transfer of the latter's sterling holdings, the Union would soon have to pay gold to Belgium in settlement of its resulting credit while not receiving any gold from Italy. If, on the other hand, Belgium should run an import surplus with the U. K., Belgium would soon have to make gold payments to the EPU while the U. K. would finance its export surplus with Belgium by having its EPU debit balance drawn down and would not be entitled to gold receipts. Thus the arrangement would entail the possibility of both gold gains and gold losses for the EPU. Only if one of the above provisions in favor of the U. K. were adopted, would the probabilities definitely be weighted in the direction of gold losses by the EPU.

III. Transfers of Sterling from Rest of Sterling Area

The Chancellor's memorandum to the OEEC Council ^{1/} maintains that a problem similar to that of the European accumulations of sterling, exists with respect to transfers of sterling from the rest of the Sterling Area to the accounts of Continental countries. According to the memorandum, it would not be just to require the United Kingdom to settle its bilateral deficits partly in gold while its bilateral surpluses might be offset by equivalent deficits of the sterling area countries. This argument seems to overlook the fact that, as long as the U. K. administers the central reserve pool for the sterling area as a whole, it must bear a share of responsibility for balance of payments developments in the sterling area. When in 1949 much of the gold and dollar drain was found to originate in excessive dollar imports of the sterling area countries, the U. K. was able to bring pressure on the self-governing Dominions to share in the cuts of dollar imports.

A similar action would be indicated and would no doubt be possible should the U. K. find at some future time that it is losing gold to the EPU as a result largely of adverse balance of payments developments of the sterling area countries vis-a-vis Continental Europe. As mentioned above, the responsibility of the U. K. for the whole trade of the sterling area with Europe could be taken account of by having the U. K. quota based on the figures relating to total sterling area trade with Europe rather than on U. K. trade alone.

IV. Freedom to Impose Quantitative Restrictions

The dispute on the freedom to establish QR's in the case of gold losses to the EPU should not be insoluble. It must be realized that the establishment of multilateral clearing itself will do away with many QR's that so far were necessary to guarantee bilateral balance. Therefore the establishment of multilateral clearing, even if unaccompanied by any commitment concerning the future recourse to QR's, is likely to result in a decreased need for and, therefore, in less current use of QR's. This is indeed the main reason for which both global multilateralism and regional multilateral clearing schemes have been advocated.

It, therefore, would be needless perfectionism to jeopardize agreement on the EPU by a dispute on this matter. Several countries are likely to insist that a clause permitting them to impose additional QR's in case of gold losses to the EPU be written into the EPU convention. Given the present lack of coordination of national monetary and fiscal policies, resort to QR's simply cannot be outlawed if there are to be gold payments by debtors.

It is of course desirable to circumscribe the use of QR's. Thus it ought to be possible to stipulate that QR's should be resorted to only in the event of persistent and substantial gold losses. Further, an attempt might be made to permit only QR's applying to the other EPU countries as a group and to outlaw bilateral ones. Finally provision should be made for consultation prior to the imposition of QR's.

1/ op. cit.

When all of this will have been done, however, the frequency of the resort to QR's will still depend essentially on the progress of the European countries toward balanced payments and toward coordination of monetary and fiscal policies.

It might also be noted that in view of the relatively small influence which the U. K. exercises over the internal policies of the self-governing Dominions, pressure by the U. K. on these countries will generally take the form of exhortation to cut imports rather than of advice on such specifically internal measures as monetary and fiscal policies.

Summary. An agreement with the U. K. on the EPU might contain the following elements:

The U. K. agrees to the establishment of an over-all limit to its over-draft facilities with respect to all EPU members as a group; beyond this limit partial gold payments are to begin. In addition, the U. K. agrees to the transfer of existing European sterling balances to the EPU accounts.

To obtain agreement on these points, the United Kingdom could be offered special benefits such as reduction or partial funding of balances, or arrangements that would permit the U. K. to receive gold payments for intra-European credits before full reimbursement of its EPU debit.

If existing arrangements with respect to the current use of sterling are to be maintained, the U. K. account with the EPU will necessarily be affected by, and the U. K. must be in some degree responsible for, the transactions that take place between the rest of the sterling area and Continental Europe; but, in compensation, the U. K.'s quota and therefore its overdraft facilities might be based on the trade of the sterling area as a whole with the other ERP countries.

Since multilateral clearing will lessen the need for QR's, its establishment itself is a positive step in the direction of trade liberalization whether or not accompanied by an explicit commitment not to reintroduce QR's in the case of gold losses to the EPU. An effort should be made to obtain reasonable assurances on this point, but undue emphasis should not be placed on it, since everything in this sphere will depend not on present commitments, but on the progress of European countries toward balanced payments and on the future growth of European unification.

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THE DOUBLE PRICE SYSTEM IN CZECHOSLOVAKIA

Gregory Grossman

Slightly more than a year has passed since Czechoslovakia introduced a double price system for consumers' goods, along with a number of parallel and ancillary measures. These measures are notable more for their extreme nature than for the novelty of their features. Although not unexpectedly, the volume of published Czechoslovak economic statistics has unfortunately shrunk severely during the last year and the trustworthiness of the information may well be questioned, which precludes a precise evaluation of the experience under these measures. It is possible, however, to sketch a broad picture of the operation of the double price system during its first year and to draw certain general conclusions.

Background

At the beginning of 1949, the outlook with respect to consumer supply and monetary stability was far from reassuring to the newly-installed communist regime. Although the 1948 crop had been good, the effects of the disastrous crop failure of 1947 were still felt. The number of livestock was only beginning to recover from the slaughter caused by the shortage of fodder at the time of the crop failure. Stocks of foodstuffs still required replenishment. Industrial consumers' goods were being diverted for export to Russia in repayment for the extraordinary imports of 600,000 tons of grain. The foreign exchange situation was critical (as had been the case for some time and still is), and was endangering the adequate flow of imported raw materials, especially those needed in the textile and footwear industries. In addition, a certain amount of uncertainty and economic loss was undoubtedly present as a result of the political coup of the preceding February, and the monetary situation was deteriorating rapidly. A very effective monetary conversion had been carried out in November 1945, but its gains had been lost later, so that at the end of 1948 currency in circulation reached a level corresponding to more than one-third the national income, whereas in 1937, the ratio was less than one-seventh.

Although the Five-Year Plan, promising even greater pressure on monetary and real resources, was just being launched and comprehensive consumer rationing and price controls were still in force, the government was clearly faced with a compelling urgency for positive action, lest the deteriorating situation with respect to consumer supply and monetary circulation got out of hand. The solution chosen was the double price system, patterned to a large extent after that employed in the Soviet Union on two critical occasions in the past -- the initial difficult years of the planning period, 1929--1935, and the war and reconstruction years, 1944 -- 1947. The Soviet experience with the system seems, on the whole, to have been satisfactory although it may have attracted more attention and been given credit for more achievement by its proponents than it actually deserved. In both instances it was abandoned by the Soviet Union relatively soon after the consumer supply situation showed definite signs of improvement; its abandonment in 1947 was combined with an extreme monetary reform. Several of the satellite countries have also tried the system in recent years.

Features of the Double Price System

Double prices were introduced in Czechoslovakia on January 5, 1949, and the system underwent considerable modification during the first year of its existence. Originally, it covered principally textiles, clothing, footwear, soap, automobiles, and automotive supplies, and new ration cards were issued for these commodities.^{1/} Rationed prices were raised considerably (in some cases up to 100 per cent), and limited quantities of the identical commodities were placed on "free" sale (that is, not requiring ration cards for their purchase) at prices generally from three to ten times as high as the new rationed prices. At the same time, a number of old indirect taxes were consolidated into the new "general tax", which was also the fiscal device employed to absorb the difference between rationed and "free" prices. The general tax is therefore a close counterpart of the Soviet turnover tax. By this time virtually all of Czechoslovak industrial production, agricultural procurement and wholesale trade, as well as an important segment of retail trade had been nationalized (or was under state-supervised co-operative management). This greatly facilitated the introduction of the new system and its strict supervision by the state.

In February, 1949, high-quality foodstuffs were added to the list of goods under the double price system, (chiefly butter, eggs, canned meat, coffee, tea, and alcoholic beverages) with approximately the same relationship between free and rationed prices as in the case of the original list. At about the same time, but not necessarily connected, the government acted to abolish subsidies on certain items of food and clothing. The subsidies had been in existence since April 1947, and had amounted to 3.5 billion korunas in 1948. This action affected rationed prices only, while in the case of free prices the higher cost to the distribution system presumably was absorbed by reducing the respective rates of the general tax.

On June 1, free prices for a number of commodities, chiefly textiles, clothing, footwear, bicycles, gasoline, and cameras, were reduced from 20 to 50 per cent. Another important development occurred on October 1, when the rationing of bread, flour, flour products, and potatoes was abolished and the items were placed on the market for unrestricted sale. The price of bread remained unchanged, but prices of flour and of flour products were raised considerably. None of the items taken off the rationing list had been under the double price system. Also, at about the same time, it was announced that a system of ration-free restaurants, charging higher prices, would be opened and that free prices for butter, sugar, soap, and beverages would be reduced. Yet another relaxation in the free prices of foodstuffs was announced for December 1, and additional food items, chiefly of the luxury variety, were placed on free sale. Prices of textiles and shoes on the free market were reduced considerably on December 31, 1949, and it was also stated that henceforth ration cards for clothing and shoes would be issued to all Czechoslovak

^{1/} But not to all consumers, as indicated later.

citizens, which represented a relaxation of the class-bias policy, discussed below.

Purposes of the System

The Czechoslovak double price system admittedly was devised to accomplish three purposes simultaneously: (1) to withdraw excessive amounts of currency from circulation, using the fiscal device of the general tax, (2) to place additional pressure on the economic position of the remaining "capitalist" classes, and (3) to enhance the incentives of labor, management, and farmers towards greater production efforts.

Disinflation. Doubt was immediately cast on the effectiveness of the double price system as a means of withdrawing currency from circulation. Since no contraction of bank credit was anticipated it would have been necessary for the general tax receipts to provide a budgetary surplus of receipts over expenditures in order to reduce the amount of currency in circulation.

However, the Czechoslovak budget for 1949 balanced at 89.3 billion korunas, with 47.7 billion korunas to be provided by the new general tax. Apparently, the treasury as such did not expect to withdraw any money from circulation at the beginning of the year. The most that could be claimed for the double price system was that it balanced the budget and did away with the large annual deficits characteristic of previous years. This in itself may be regarded as a creditable fiscal achievement. In fact, however, a certain increase in circulation might well be expected from the direction of the banking system despite the balanced budget, since it would be hard to imagine that the newly-launched Five-Year Plan would not have caused some increase in bank credit.

The detailed publication of state receipts ceased with July figures but the first seven months of the year showed that the general tax had yielded 34.4 billion korunas, or 6.6 billion more than the anticipated collections. Total budgetary receipts during the seven months exceeded the anticipated amount for the same period by as much as 23.9 billion korunas.^{1/} These figures suggest that either the free prices were planned at too high a level for the desired revenue from the general tax, or that the demand in the free market exceeded the expectations of the planners. In any case, they help to explain the substantial reductions in free prices which were carried out on June 1, as outlined above, as well as the several subsequent cuts. They also suggest that the abolition of subsidies in February 1949 was undertaken not as an economy measure, but more likely for the purpose of bringing order into the price-cost structure at the outset of the Five-Year Plan.

Currency circulation, which stood at a peak of 75.6 billion korunas at the end of 1948, declined to 67.7 billion korunas in the first half of 1949 and then started to rise slowly again, reaching 70.1 billion korunas at

^{1/} This does not necessarily mean that an equivalent budgetary surplus was being accumulated. No statistics on state expenditures have been published, and it is possible that expenditures were also increased in view of the favorable receipts.

the end of November 1949. A decided reduction in the amount of currency in circulation was thus achieved, thanks to better-than-anticipated tax receipts. It would be erroneous, however, to gauge the developments with respect to monetary stability on the basis of circulation statistics alone, since a thorough reorganization of banking and industry was going on concurrently. The number of banks was reduced to but a few;^{1/} the number of industrial and commercial establishments was also being reduced, and -- in line with Soviet practice -- state-owned enterprises were enjoined from keeping more than the minimum of cash on hand. These reforms would, in any case, have called for a smaller amount of currency in circulation. On the basis of available information it is impossible to answer the question whether money supply has or has not become any tighter from the point of view of the public which, in a socialist economy, is the relevant question with respect to monetary stability and its effect on incentives.^{2/} Commercial deposits ("current accounts of first depositors") rose sharply from 53.3 billion korunas at the end of 1948 to 111.2 billion korunas at the end of October 1949, indicating a large increase in bank credit to enterprises in connection with the Five-Year Plan, and also possibly the accumulation of the higher-than-anticipated treasury receipts in the treasury's bank accounts.

Class bias. Discrimination between the various classes of the population has been a prominent feature of the double price system from the very outset. The new ration cards issued in connection with the introduction of the system were expressly withheld from individuals whom the regime considered as belonging to the "capitalist" classes, and also from members of their families. Such individuals included private entrepreneurs; professional people not belonging to their respective syndicates (which, by that time, had practically become organs of the regime); farmers owning over 15 hectares of land, or failing to fulfill the government's delivery quotas and sowing plans; and workers not employed full time for the preceding three months. These persons were thus forced either to do without new purchases of the commodities covered by the double price system, or to buy them at the very high prices in the free market. Apart from staple foodstuffs such as bread and potatoes, this applied to most articles of consumption generally considered as necessities. Proprietors of retail stores were in addition severely hit by the special tax on retail inventories imposed at the time of introduction of the double price system.

These measures undoubtedly speeded the economic and financial ruin of the bourgeoisie and the wealthier peasantry. It must be remembered, however, that they were not the only measures aimed toward that end, but were part of a concerted and determined drive, employing virtually all methods at its disposal

1/ A further reduction, leaving only two credit institutions (State Bank and Investment Bank) has just been announced.

2/ Cf. "Efforts Toward Monetary Stability in the USSR", this Review, November 22, 1949.

up to and including police terrorism, to transform Czechoslovakia into what the regime conceived to be a socialist state. The relaxation of the class bias in the double price system at the end of 1949, allowing all Czechoslovak citizens to obtain ration cards for clothing and shoes, may indicate that the "capitalist" classes on the whole had already been financially depleted to the point where no more cash could be obtained from them at the high free prices. The measure may also signify some consolidation of the regime's internal position and progress towards its socio-economic goals.

Incentives and consumer supply. It would be very difficult to pass judgment on the efficacy of a double price system as a spur to incentives even if better opportunities to study it were available than exist in the case of present-day Czechoslovakia. However, we may reason a priori that the existence of a free market (i.e. not requiring ration cards) paralleling a rationed market would tend to increase the individual's interest in acquiring additional money. It should be pointed out that Czechoslovakia, following the Soviet example, has been broadening the application of piece-work rates in industry, bonus payments for outstanding production, etc., which all tend to tie the individual's money income directly to his productivity. The double price system, as a fiscal device, avoids progressive income tax rates with their well-known dampening effect on incentives. We may assume, therefore, that the double price system has had some favorable impact on productivity through incentives, if only as an offsetting factor to the reported growing dissatisfaction in the ranks of labor with the authoritarian methods of the regime and with the still generally adverse situation with regard to consumer supply.

Although consumer supply is still far from satisfactory and will probably lag behind demand as long as Czechoslovakia's own combination of economic ambition and economic difficulties persists, there nevertheless has been a decided improvement over the last year. The improvement is particularly noticeable in food supply. This is borne out not only by the de-rationing of bread, flour, and potatoes, and several other relaxations, but also by the reports of responsible foreign observers in Prague. It is difficult to say whether the double price system, through its influence on productivity and farm deliveries, can claim a substantial share of the credit for this development. A major part of the credit should undoubtedly go to the two good crop years subsequent to the crop failure of 1947. The improvement in food supply may also be a spurious favorable effect of Czechoslovakia's grave foreign exchange position. The forced orientation of its trade to the east is in large measure responsible for the shortage of hard currencies and sterling which Czechoslovakia requires very urgently, but at the same time it causes the country to import greater quantities of grain and other foodstuffs as counter-value for Czechoslovak deliveries of industrial products to the USSR and its satellites. Moreover, the low level of trade with the west may allow more industrial consumers' goods -- traditional exports to the west -- to be retained in the country, insofar as the resources are not shifted away to the heavy industries. Thus, although a more traditional distribution might be on the whole much more economic, the existing pattern may be of some specific benefits to the consumer.

Conclusion

Judging from recent Czech experience and from previous Soviet practice, it would seem that under conditions of consumer shortages and actual or potential repressed inflation, the double price system for consumers may be a rather effective method to preserve a modicum of incentives among producers and to provide the treasury with a fiscal device to maintain (or re-establish) monetary stability. It should be pointed out that the pre-existence of a repressed inflation (a monetary overhang) is in itself not a necessary condition for a double price system. Monetary circulation may be sufficiently low and the existing fiscal structure capable of keeping it at that level, while consumers' goods may be in such short supply as to require the imposition of rationing at low prices or social reasons, which in turn may be destructive of incentives. The introduction of such a measure may of itself create a mild repressed inflation, so that the free (unrationed) sale of a part of the supply of otherwise rationed commodities may well be introduced to lend additional attraction to monetary rewards.

Nor would it seem that a double price system is not applicable to private enterprise economies under conditions of extraordinary dearth of consumers' goods, as in wartime. We have accepted the fact that effective rationing is possible under private enterprise, although it is undoubtedly inimical to the best performance of private enterprise. Similarly, tax laws could be so devised as to allow for the sale (without ration coupons) of a part of the output of a private producer at prices higher than those at which he sells (against ration coupons) the rest of his output. Actual instances of similar practice could undoubtedly be found in the history of public finance. The problems of enforcement of such a system are liable to be serious, however.

Lastly, it may be worth pointing out that the class bias of the Czechoslovak double price system is not an essential feature of double pricing. However, double pricing involves comprehensive administrative control over the economy and thus permits (as is true of any such control) discriminatory practices on the part of those who exercise sufficient political power to use the controls in that particular way.