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March 3, 1953

Internal Financial Situation in the United Kingdom

Samuel I. Katz

7 pages

The Impact of the Flood on the Netherlands' Economy

Frederick R. Dahl

8 pages

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March 3, 1953

Internal Financial Situation in the United Kingdom - Samuel I. Katz

From April to December 1952, the volume of private credit in the United Kingdom declined, but Treasury borrowing from the banking system increased heavily, leading to a substantial expansion in deposits. The Exchequer normally has seasonal needs for short-term funds during the first three quarters of the fiscal year in anticipation of the heavy revenue inflow during the January-March period. In 1952, however, the borrowing has been larger than in 1951, first, because the budget deficit to the end of December proved to be substantially larger than in 1951, and, secondly, because of the domestic monetary impact of the improvement in the country's balance of international payments. Under the Exchange Equilization Account technique, the termination of an import deficit produces a drain upon the cash resources of the Treasury since the Account must provide sterling to exporters in exchange for the foreign currencies accrued.

Private borrowing checked.

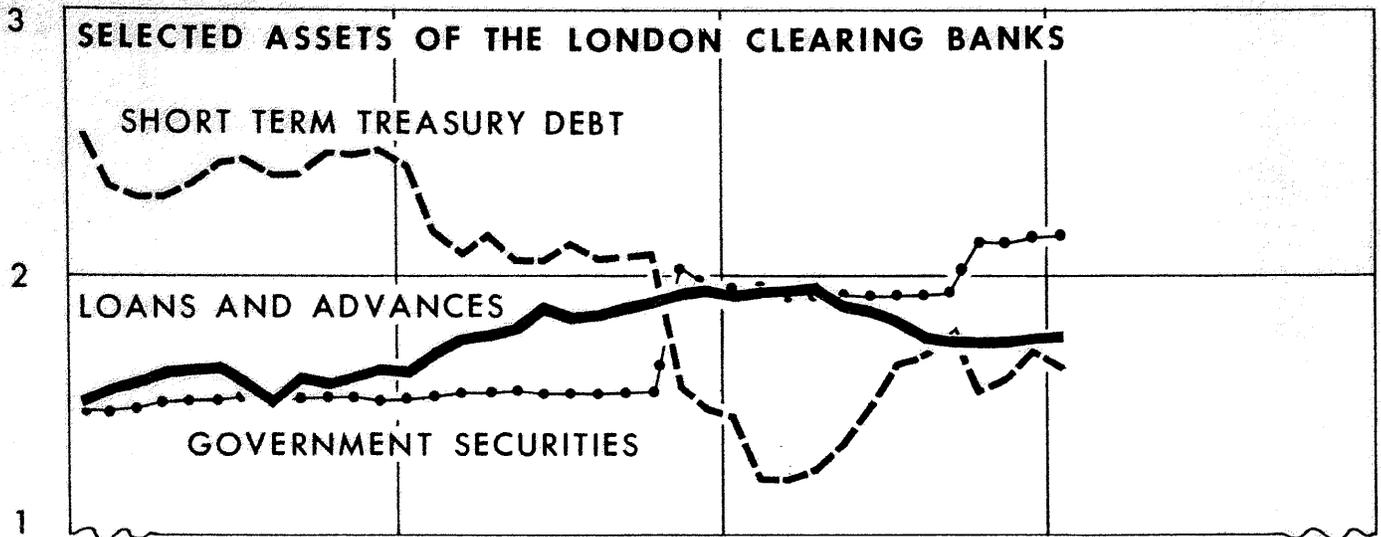
From April to December 1952, lending to the private sector by the eleven London clearing banks was reduced by £307 million. The curtailment in commercial loans amounted to £197 million and the reduction in their portfolio of commercial bills to £110 million. (Appendix - Table I). This decline was due to the anti-inflationary monetary policy inaugurated in November 1951 and intensified in March 1952; to the levelling of raw material prices in world markets; and to a decline in the demand for certain consumer goods. These elements brought to an end the inventory accumulation of imported raw materials and of processed goods at varying levels of distribution which had been largely responsible for both the rapid expansion in private lending and the large import surplus during 1951. In reaction to the heavy buying during 1951, a mild recession in textiles and clothing and in some durable consumer industries was experienced during the second and third quarters of 1952, resulting in a lagging in the index of industrial production. (See chart).

Some light of the relative importance of these factors upon bank lending is shed by the distribution by industries of credit cuts by all British banks from March to November 1952 (Appendix - Table II). Textiles, retail trade, and food and drink industries accounted for about 41 per cent of the total decline in bank loans during the period: these sectors were most affected by the decline in consumer demand during the past year. They were also important sources of credit expansion in the preceding twelve months, accounting for about one-third of the total £333 million increase between December 1950 and November 1951 shown in Table II. On the other hand, the drop in financial, professional and personal loans accounted for 27 per cent of the recent decline: these categories as well as the commercial bill portfolio were more directly affected by the anti-inflationary monetary measures.

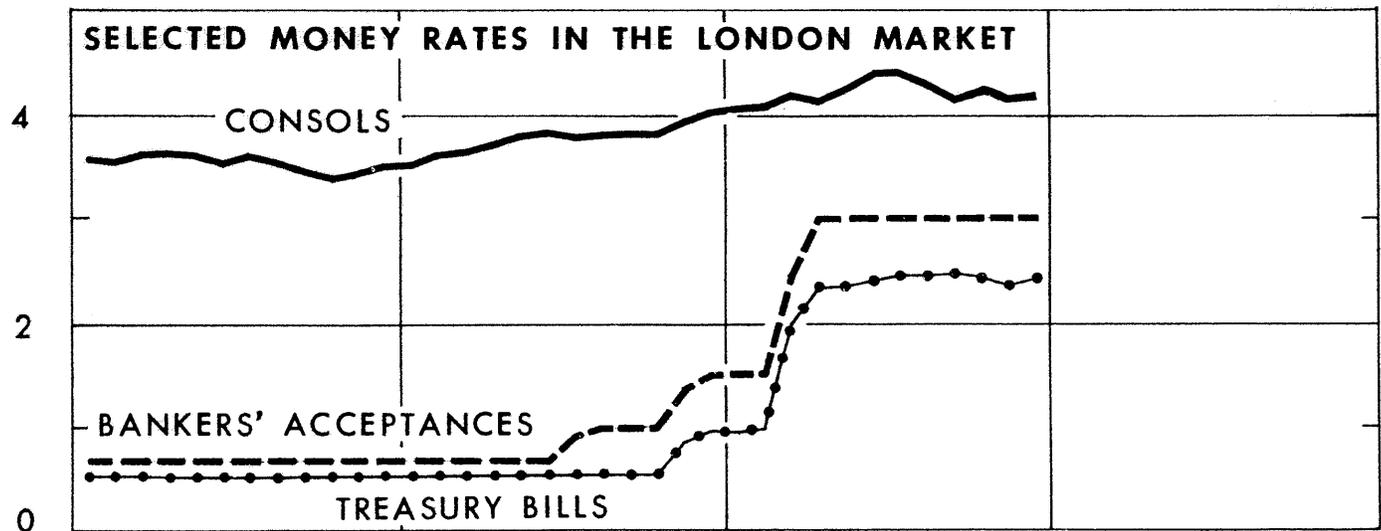
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# UNITED KINGDOM

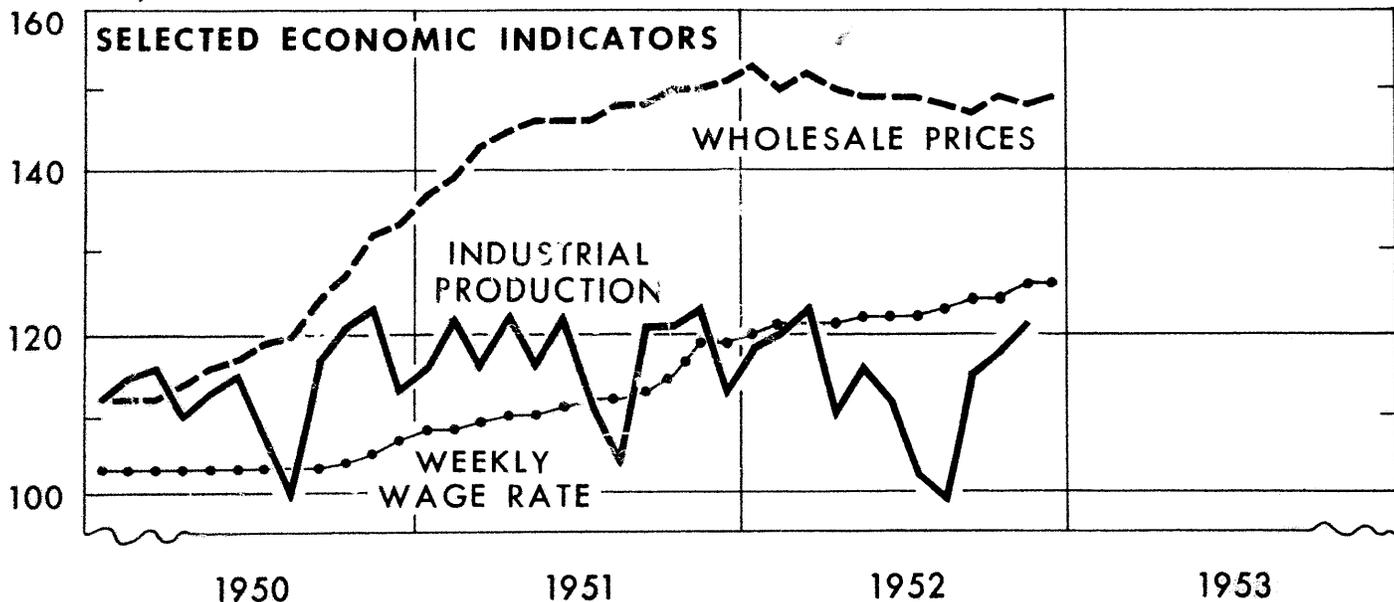
Billions of Pounds



Per Cent Per Annum



Indexes, 1948 = 100



Budget deficit exceeds estimates

Contrary to the estimates of the Chancellor in March 1952, the budget deficit for the current fiscal year (ending March 31, 1953) will be substantially larger than in 1951-52. For the first three quarters of the fiscal year, the deficit amounted to £977 million; the tax inflow during the current quarter is likely to reduce the deficit to around £250 to 300 million for the fiscal year compared to a forecasted deficit of £24 million announced last March.

For the year as a whole, the Chancellor had expected a £125 million improvement compared to the 1951-52 results; but the outturn for the first nine months of 1952-53 was a £375 million larger deficit than for the same period in 1951. This deterioration seems to be due in about equal parts to a shortfall in tax revenue and to an increase in expenditures (Appendix - Table III). The recession in consumer goods industries reduced corporate and excise tax receipts; severe import restrictions, coupled with the 10-per cent fall in import prices during 1952, reduced customs receipts below the level expected in March 1952. Income tax revenue was also reduced as a result of the increased tax-free allowance granted last March.

On the expenditure side, the rise in interest rates (see chart) increased servicing costs of the national debt more than had been expected; defense category expenditures were also heavier, despite some curtailments and the slowing down of stockpiling of strategic material. Loans to local government units increased and comprised 8 1/2 per cent of all budget expenditures to the end of December; these funds are used for financing housing projects by the local governmental bodies and, to a minor extent, for education. 1/

Treasury borrows mainly from banking system

Since April 1952, the Treasury has been forced to borrow from the banking system some £718 million, more than double the cutback in private credit (Appendix - Table I). By contrast, during the same period in 1951, the banks were not called upon to provide funds to the Treasury against Treasury bills. Instead, the Exchequer was able to finance itself out of the sterling which British importers surrendered to the Exchange Equalization Account for the foreign currencies they required; during the second half of 1951, for example, this net sterling accrual amounted to £483 million (Appendix - Table IV).

1/ These loans are now at market rates of interest, the rate for loans exceeding 15 years having been raised from 3 3/4 per cent to 4 1/4 per cent on February 8, 1952.

Under the Exchange Equalization Account technique in effect in Britain, an import deficit on current account is a source of revenue to the Exchequer. <sup>1/</sup> The Account receives sterling from British importers and automatically lends the funds to the Treasury by purchasing Treasury bills. When the external drain is halted, as occurred in the first quarter of 1952, this source of sterling financing for the Treasury is no longer operative. On the contrary, the Account sells Treasury bills to the market to obtain sterling to purchase accruing foreign exchange, seeking sterling funds in competition with the Treasury. In such circumstances, the banking system tends to function as a residual lender.

The existence of an important source of sterling during 1951 accruing from the external deficit, and the termination of this supply during 1952 when the balance of payments position was restored, explain why the Treasury was able to abstain from borrowing from the clearing banks during 1951 and, in turn, had to rely so heavily upon them during the same period in 1952. In this way, the improvement in the balance of payments during 1952 - growing in part out of the anti-inflationary monetary measures - tended to hamper the domestic effectiveness of these same measures. During the April - December period, the decline of £307 million in commercial bank lending to the private sector was more than offset by the rise of £718 million in bank lending to the Treasury. Mainly because of these movements, the money supply in the United Kingdom - as reflected by net deposits - rose by £467 million as compared to a rise of only £221 million in the April to December period in 1951.

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<sup>1/</sup> W. Manning Dacey, The British Banking Mechanism, (London: 1951) p. 114.

APPENDIX

Table I

London Clearing Banks:

Changes in net Deposits and Selected Assets

(In millions of pounds)

	April	to	December
	1950	1951	1952
Net deposits	+ 521	+ 221	+ 467
Lending to Treasury:			
Short-term <u>a/</u>	+ 372	- 413	+ 504
Securities	+ 25	+ 412	+ 214
Total	+ 397	- 1	+ 718
Private lending:			
Advances	+ 50	+ 177	- 197
Commercial bills	<u>b/</u>	<u>b/</u>	- 110
Total	+ 50	+ 177	- 307

a/ Includes Treasury bills, Treasury Deposit Receipts and call money. A minor volume of commercial bills are included during 1950 and 1951.

b/ Prior to 1952, included in "short-term lending to Treasury."

Source: Monthly Digest of Statistics

Table II

All British Banks:

Changes in Lending by Selected Industries

(In millions of pounds)

<u>Industry</u>	<u>December 1950 to November 1951</u>	<u>March to November 1952</u>
Total change, all industries	+ <u>333.0</u>	- <u>240.4</u>
Selected industries:		
Textiles	+ 41.3	- 37.4
Food and drink	+ 33.9	- 29.4
Retail trade	+ 34.4	- 31.1
Finance	+ 18.8	- 12.4
Personal and professional	+ <u>18.3</u>	- <u>51.8</u>
Total	+ 146.7	- 162.1

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Source: Monthly Digest of Statistics

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Table IIIUnited Kingdom:Budget Results, April-December 1952 with comparisons

(In millions of pounds)

	<u>April - December period</u>		<u>April - March period</u>	
	1952	change over 1951	Estimates for 1952-53	Forecast for 1952-53 com- pared with results for 1951 - 52
<b>I. <u>Revenue</u></b>				
Income tax	655.9	+ 6.2	1,804.2	+ 135.5
Profits & E.P. tax	295.1	+ 53.2	452.0	+ 136.6
Customs	774.1	+ 20.3	1,043.5	+ 45.0
Excise	549.0	- 19.5	772.0	+ 18.7
Other	337.0	- 130.4	589.7	- 107.8
Total revenue	2,612.0	- 70.2	4,661.4	+ 228.0
<b>II. <u>Expenditure</u></b>				
Ordinary expenditure:				
National debt	443.0	+ 60.4	540.0	+ 26.4
Supply services	2,634.4	+ 159.9	3,554.4	+ 92.9
Other	59.8	+ 8.9	85.0	+ 6.4
Total	3,137.2	+ 229.2	4,179.4	+ 125.7
Capital expenditure:				
Loans to local authorities	301.3	+ 31.4	344.0	- 21.0
Other	150.1	+ 43.7	162.0	- 2.0
Total	451.4	+ 75.1	506.0	- 23.0
Total expenditure	3,588.6	+ 304.3	4,685.4	+ 102.7
<b>III. <u>Total deficit</u></b>	- 976.6	+ 374.5	- 24.0	- 125.3

Table IV

United Kingdom

Effects of External Developments upon Treasury Financing

(In millions of pounds)

	Jan.-June	<u>1951</u> July-Dec.	Jan.-June	<u>1952</u> July-Dec.
Effects upon Treasury's Cash position of changes in: <u>a/</u>				
Gold and dollar assets	- 203	+ 547	+ 232	- 58
E. P. U. Debt	- 15	+ 297	+ 35	- 18
Sterling balance debt	+ 425	- 361	- 410	<u>b/</u>
Net effect	+ 207	+ 483	- 143	- 76

a/ An increase in gold and dollar assets reduces the amount of sterling in the Treasury's Exchange Equalization Account. An increase in the EPU debt increases that amount. Similarly, an increase in the sterling balance debt increases the amount of sterling available to the Treasury. In each case, a minus sign reflects an improvement, and a plus sign a deterioration in the international position of the United Kingdom.

b/ Not available.

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March 3, 1953

The Impact of the Flood on the Netherlands' Economy - Frederick R. Dahl

By 1952, the Netherlands' economy had achieved a remarkable degree of internal and external stability. During the year, wholesale prices declined slightly and the cost of living index remained virtually unchanged while wage rates rose very slightly, thereby offsetting about one-half of the decline in real wages agreed to by labor in 1951. In the last quarter of 1952, industrial production recovered from the slight recession noticeable earlier in the year and surpassed all previous records. Unemployment, adjusted for seasonal variations, though still somewhat higher than in 1951, declined steadily in the second half of the year.

The balance of payments on current account for 1952 showed a surplus for the first time in the post-war period. Exports increased by six per cent, imports declined 15 per cent, and net income from invisibles was maintained at the 1951 level. In the EPU, the Netherlands progressed from a net deficit of \$53 million in 1951 to a net surplus of \$266 million in 1952. Additions to gold and dollar reserves in 1952 amounted to \$291 million, of which, however, \$130 million resulted from non-repetitive transactions with Indonesia and another \$85 million represented the equivalent of U. S. aid. The strengthening of the economic position of the Netherlands made possible the termination of U. S. economic assistance.

Prospects appeared good for continued internal and external economic stability in 1953. The situation has, however, been changed by the tidal wave and flood disaster of February 2nd. This paper attempts to assess the importance of this disaster on the country's production, financial stability, and balance of payments. It is obvious that any such evaluation is extremely tentative since available reports on the extent of damage are often vague and sometimes conflicting.

1945 and 1953: A comparison

While the recent North Sea storm has been reported as the greatest disaster to the Netherlands since 1420, a more recent example, for the purpose of evaluation, is furnished by the inundations of 1945. In that year, the Allied powers bombed the dikes in southwestern Holland to protect their base in Antwerp. Moreover, the Germans, during their retreat in the north, flooded the Wieringermeer polder. In all, 450,000 acres were flooded in 1945, of which 200,000 acres were covered by salt water. The portion covered by fresh water was sealed off and pumped dry in 124 days. Nine months were required, however, to reclaim the Island of Walcheren and the other areas covered by salt water from the sea. While agricultural production in the north was nearly normal the following year, desalting of the soil in the south required several years before the area could be restored to full production. The cost of reclamation in 1945 has been estimated at \$156 million (at 1953 prices).

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The damage in 1953 is concentrated entirely in the southwestern portion of the Netherlands, the provinces of Zeeland, Zuid Holland, and Nord Brabant. Nearly all of Zeeland, which is formed by the islands in the Rhine estuary, was flooded. At one time, 500,000 acres were covered; but a portion of this was the result of the backing up of the Rhine and Maas rivers. The waters in these areas have already receded. About 330,000 acres remain to be reclaimed, of which 250,000 acres are covered by salt water. As in 1945, the chief problem is the reclamation and the rehabilitation of this latter portion.

The Netherlands Government has estimated that the damage amounted to 263 million dollars. Since this probably includes the value of the lost production, (\$85 million) it would seem to agree closely with the 1945 estimate.

### Agriculture

Zeeland, Zuid Holland, and Nord Brabant, the provinces affected by the floods, are centers of agricultural production. The effects of the disaster, therefore, were concentrated almost entirely on this sector of the economy. Industrial plant and equipment, shipping, and harbor services were relatively untouched.

Agriculture is a chief staple of the Netherlands' economy. Thirteen per cent of the national income is derived from agricultural production and nearly ten per cent of the total population is actively engaged in it. In 1951, farm products formed forty per cent of the Netherlands' exports.

The following agricultural commodities are grown in the flooded areas: wheat, barley, sugar beets, flax, potatoes, and onions. Table I presents the Netherlands production of these commodities in 1952, and the estimated loss of production as a result of the flood. The estimated loss of \$85 million of agricultural produce annually represents 15 per cent of total Netherlands' agricultural production.

The portion of the area covered by brackish water will be the easiest to recover and should produce normal crops by 1954. However, the experience of 1945 demonstrated that two to four years are required for the return of land covered by salt water to full production. The length of time required to seal the dikes and to drain off the land will largely determine the rate at which production is restored. At the moment, the soil is still frozen and the salt has had little opportunity to seep below the surface. However, if the land is not drained before the spring thaws, the damage will be immeasurably greater.

Table IEffect of the Flood on Agricultural Production

<u>Major Commodities</u>	<u>Production 1952</u> (1,000 metric tons)	<u>Estimated loss of production</u> (1,000 metric tons)	<u>Value of lost production</u> (In millions of dollars)
Wheat	327	62	4.2
Barley	240	67	6.1
Sugar beets	2789	698	9.2
Fiber flax	190	48	3.5
Onions	138	125	10.2
Potatoes (edible)	3302	475	6.2

Source: Production 1952 and value of production: Centraal Bureau voor de Statistiek, Maandschrift, December 1952. (The loss of production has been estimated on the basis of press reports and of information received from the Netherlands' Agricultural Attache.)

The restoration of soil damaged by salt water requires chemical treatment and fertilization. In addition, great care must be exercised in handling it. There can be little tillage and, for this reason, barley has been found to be the best crop to grow the first year. In view of the importance of the area as a producer of sugar beets, the inability to sow root crops for several years means a heavier reliance on imported sugar.

Reconstruction

The physical losses in housing, equipment and dikes represent an even heavier strain on the economy. Priority in reconstruction will be reserved for the dikes which were breached in over one hundred places. The total extent of the breaches has been estimated at 5000 meters. The cost of dike repair, at \$2600 a meter, should therefore be about \$13 million. In addition, work in strengthening and redesigning the dike system will have to be undertaken. After the reconstruction of the dikes, the draining of the polders will be largely mechanical, utilizing already existing equipment.

Housing presents a far more difficult problem. About 100,000 homes were either partially or completely destroyed. The estimated cost of housing reconstruction is \$100,000,000.

Although no industrial plants were damaged, farm and road machinery may have been lost. Roads and other means of communication will have to be restored. Other losses were relatively minor.

The reconstruction should be somewhat facilitated by the existing level of unemployment. At the end of December, 176,000 persons were unemployed. Part of the unemployment was due to seasonal factors, but the figure was larger by 22,000 than in December 1951. Of the total, 30,000 were construction workers and over 30,000 were agricultural laborers. The unemployed agricultural workers are primarily in the northern provinces of Friesland and Groningen, but the unemployed construction workers are located in industrial areas of central Holland close to the inundated region. Both of these groups, however, can be used for reconstruction only if they can be persuaded to move from their homes and if housing facilities can be provided for them.

This source of labor will be swelled by the population of the flooded areas themselves. The region has a population of over 300,000 persons and at least one-half of the adult male population, or about 60,000 men, should be available to take part in the reconstruction work.

The rebuilding and repairing of houses will probably require about 200,000,000 man-hours of labor while dike reconstruction may well require an additional 50,000,000 man-hours. On this basis, the rebuilding of the dikes would utilize 80,000 men over a period of three months and housing construction would need 95,000 men during a ten month period. If the population of the flooded areas can be used and, if the unemployed of other areas can be shifted, manpower will be available for reconstruction purposes and, at the same time, unemployment would virtually disappear.

#### Domestic finance

The internal financial stability of the Netherlands need not be threatened by reconstruction financing. The extent of the damage, using the Government's estimate, amounts to six per cent of the national income. As will be seen below, about one-third of the loss can be made up in the foreign trade sector. Another one-third may well be offset by normal advances in technology and productivity. The remaining two per cent may be covered by the utilization of formerly unemployed resources.

Assuming no changes in the pattern of consumption, there is little likelihood of a recurrence of inflationary pressure as a result of reconstruction. The materials component of reconstruction falls nearly entirely on the international rather than the domestic account, and the necessary manpower may be taken from the ranks of the unemployed instead

of from existing occupations so that there need be no secondary burden on current production. Should consumption increase, however, investments -- e.g., the reclamation of the Zuider Zee -- could be adjusted accordingly.

To finance a portion of reconstruction costs, the Netherlands' Government has decided to postpone proposed tax cuts and has floated a fl.200 million (\$53 million) bond issue. By choosing these methods rather than to diminish the Treasury cash balances or to monetize counterpart, the Government has further counteracted the danger of inflationary effects.

Foreign trade

The foreign trade and balance of payments of the Netherlands, however, will be significantly affected by the recent floods. All of the commodities listed above are important as export or import-saving items. Table II below estimates how the loss of production would have affected foreign trade in 1952.

Table II

Estimated Effects of Flood on Foreign Trade

<u>Commodity</u>	<u>Net trade 1952</u> (1,000 metric tons)		<u>Loss of Exports</u> (In millions of dollars)	<u>Required Additional Imports</u> (In millions of dollars) <u>3/</u>
	<u>1/</u>	<u>2/</u>		
Wheat	743	(M)	--	6
Barley	202	(M)	--	5
Fiber Flax	126	(X)	10	--
Potatoes	475	(X)	25	--
Onions	116	(X)	9	--
Sugar beets	---		--	--
(Raw cane sugar)	370	(M)	--	11
(Refined sugar)	<u>119</u>	(X)	--	--
Total			44	22

1/ Imports (M); Exports (X).

2/ Based on first ten months figures expressed at an annual rate.

3/ Estimated on the basis of satisfying domestic requirements and maintaining existing exports.

Source: Centraal Bureau voor de Statistiek, Maandstatistiek Van De In--, Uit-- En Doorvoer Per Goederensoort, October 1952.

This table, however, reveals only the immediate effects of the loss of production on foreign trade. The loss in secondary products is more difficult to approximate. Sugar beet pulp, for example, is used as fodder. The loss of sugar beet production, therefore, will require alternative sources of feedstuffs, consisting of additional imports of coarse grains or of oil cakes and meals. Sugar beets, themselves, are not available from other sources of supply and are normally too bulky to enter into trade. Imports of substitute feedstuffs will be approximately \$10 million.

Other import requirements will be stone and cement for reconstruction purposes and fertilizers for treating the salt-covered land. These import requirements may be estimated at \$10 million.

Table III

The Netherlands' Balance of Payments

(In millions of dollars)

	<u>1952</u> <u>1/</u>	<u>Estimated 1953</u>
Imports (f.o.b.)	2026	2064
Exports (f.o.b.)	2105	2061
Deficit (-) or Surplus (+)	+ 79	- 3
Net Services	+322 <u>2/</u>	+300
Balance on Goods and Services	+401	+297

1/ Preliminary.

2/ First half-year, expressed at an annual rate.

Source: Table II.

I.M.F., International Financial Statistics, February 1953.

The effect of the flood on the Netherlands' balance of payments (Table III) is estimated on the basis of trade figures for 1952, under the assumption that little change would take place in the basic pattern of imports and exports in 1953. Increased imports for restocking purposes, for example, are not taken into consideration. Net service income is expected to decline slightly in 1953 because of lower freight rates in 1952 and increased transportation payments for additional imports in 1953.

About one-third of the deterioration in the Netherlands' balance of payments is likely to be with the dollar area. Additional imports of wheat, barley, feedstuffs, and sugar will come primarily from the United States, Canada and the West Indies. In 1952, the Netherlands had a current account deficit with the United States and Canada of about \$90 million. Increased imports in 1953 should increase this deficit to \$125 million.

However, Netherlands' gold and dollar holdings should continue to increase in 1953, although only by a small fraction of the 1952 rise. Settlements through the EPU (\$50 million), transactions with Indonesia (\$50 million), United States aid--"pipeline"--(\$35 million), and dollar earnings from Latin America (\$35 million) are expected to more than offset the deficit with the United States and Canada, thereby raising gold and dollar reserves by about \$45 million.

Foreign trade prospects for 1954 are more difficult to estimate. Barley will be the chief crop grown in the flooded area with acreage yields of about 60 per cent of normal. Additional imports of barley should be unnecessary, as the greater acreage planted should offset the loss of yield. Part of the feedstuff problem probably can be solved through greater utilization of barley. Also, the area covered by fresh water should be in normal production and imports of reconstruction materials will be greatly reduced. The saving in terms of imports in 1954 should, therefore, amount to approximately \$20 million. In 1955, little barley will be grown but most crops should be in partial production and the over-all effect will probably be more favorable. A normal volume of trade in these commodities cannot be expected until 1956.

### Conclusion

The greatest impact of the flood damage falls on the foreign trade rather than the domestic sector of the Netherlands' economy. Manpower for the labor component of reconstruction is available from unemployment. There need be no substantial decline in national income or consumption. Unless labor immobility threatens the success of reconstruction, or increased consumption puts a strain on the country's resources, the current level of investments might also be maintained. Full agricultural production should be restored by 1956.

The balance of payments of the Netherlands will, therefore, reflect the most significant change through the loss of agricultural exports and the need for additional imports to meet domestic consumption requirements and to maintain exports as well as to provide materials for reconstruction. Nevertheless, a surplus on current account is still probable for 1953. The deficit with the dollar area should be covered and gold and dollar reserves should rise by about \$45 million.

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