

Board of Governors of the Federal Reserve System
Division of Research and Statistics
International Section

REVIEW OF FOREIGN DEVELOPMENTS

February 11, 1946

Counter-Inflationary Measures in Hungary.... 1
Effect of Income Changes on American
Invisible Imports..... 5
Exchange Rates of Balkan Currencies..... 7
Lend-Lease "Pipeline" Agreement with Russia. 8
Switzerland's Foreign Lending in the
Post-War Period..... 9
India Calls In Large Denomination Notes.....11

.....

Counter-Inflationary Measures in Hungary*

Cornelia B. Rose, Jr.

Just before Christmas, the Hungarian Government put into effect a currency reduction scheme which was advertised as a means of checking the dizzy inflation in this country. However, not even the sponsors of the plan hoped that it would be more than a moderating influence for a brief time, and the opinion was generally held that the main purpose was political: the Government had been criticized ever since its formation in November for failure to take drastic action to meet the serious economic situation here, and this was its answer.

It had been intended to put the scheme into effect in the week between Christmas and New Year's when commercial activity would be at a low point. However, rumors began to spread, and the decree was announced December 19th. Notes of 1,000, 10,000, and 100,000 pengő to be worth their face value had to have adhesive stamps affixed. Smaller notes were exempted and retained their original value unstamped. The required stamps cost three times the value of the note to be stamped. Thus, the price of a stamp for a 1,000 pengő note was 3,000 pengő. Stamps were on sale at banks and post offices, and the proceeds were turned over to the Treasury. At the time of this decree, the total circulation in Hungary was about 600 billion pengő, most of it in the large denomination notes. The withdrawal of three-quarters of the currency affected, according to the most optimistic estimates, would provide the Government with a maximum of 400 billion pengő or about enough to cover expenditures for ten days after which further recourse

*Editor's Note - The author of this article, formerly managing editor of this Review, is now residing in Hungary. She sends us from Budapest this interesting inside view of one of Europe's most disordered monetary situations.

would have to be had to the printing press. It is doubtful if the breathing space lasted even that long. On January 7, bank note circulation was 778 billion pengö, and it is rising at the rate of about 30 to 40 billion pengö per day.

Much confusion in the use of currency accompanied the valorization. Unstamped notes could be used--at 25 per cent of their face value--until December 31, and were redeemable at the National Bank until January 12. Before the end of the year, the 100,000 pengö note, first issued on December 15, appeared in a new color to be used at face value, unstamped. The original announcement of the plan failed to specify which color of stamp was to be used on which note, so that some people were able to pass the largest note bearing stamps intended for the smallest. Within a week, the stamps (some stolen, some counterfeit) began to appear on the black market at half-price, the countervalue going not to the Treasury but into the pockets of speculators. Making change became a fine art. If one paid a 200 pengö streetcar fare with a stamped 1,000 pengö note, the change might be three unstamped 1,000 pengö notes and 50 pengö; if with an unstamped 1,000 pengö note, it was 50 pengö; but if a 500 pengö note was used, the change was 300 pengö or an unstamped 1,000 pengö plus 50 pengö.

The hope expressed in official statements that prices would drop with the reduction of the amount of money in circulation was not borne out to any great extent. Prices, which change daily or even hourly here, had been boosted in anticipation of the decree and at first remained where they were, when shopkeepers could be persuaded to sell at all. Everything was three times as expensive as previously while people in general had only one-quarter as much money. There was some justification for the merchants because, while their cash holdings had been reduced, their liabilities were unchanged. It was forbidden to lower wages; and debts likewise were not affected. Neither were bank deposits, but bank holdings of cash were. These institutions were in a particularly bad spot; although they had been ordered to close on December 18, the news had spread the preceding day that bank accounts were not to be affected and people had rushed to make deposits. Bank cash on hand, therefore, was abnormally large on December 19. To afford some relief it was later decided that the banks need not buy stamps for "excessive" cash holdings; the determination of what was "excessive" was discretionary with the National Bank.

Eventually, under pressure, merchants agreed to reduce prices, but generally not more than 10 or 25 per cent, and few people had enough cash to take advantage of the drop. Food prices fell more than any other single category of goods, but even here the effect was purely transitory. Prices turned up again before the end of December, and now inflation is once more in full swing. The table below shows the semi-official index of the Hungarian Economic Institute for the period in question.

Cost-of-Living Index
(July 15, 1945 = 1)

<u>Date</u>	<u>Food</u>	<u>Clothing</u>	<u>Heat and Light</u>	<u>Rent</u>	<u>Combined Index</u>
Dec. 5	269	189	186	9	224
12	443	263	240	9	353
19	719	327	282	20	555
27	350	266	232	20	302
Jan. 2	593	266	282	126 ^{1/}	463

^{1/} Reflecting imposition of rent tax, see below.

The repercussions of the currency scheme on the foreign exchange market were pronounced. Immediately prior to December 19, the dollar rate had risen sharply: on December 17, rates from 400,000 to 900,000 peng^o were quoted, compared with 190,000 peng^o on the preceding business day. By December 20, the dollar had fallen to 100,000 peng^o and a bit above. The National Bank, which buys dollars at a rate announced the day before, usually about half of the black market rate, found that it was paying more than the black market rate and was deluged with customers. The Bank lowered its rate for several successive days, and also requested all banks not to buy for their own account but to send sellers of foreign exchange to the central institution where only relatively few customers could be handled in a day. The reluctance on the part of the National Bank to take dollars can be explained by the fear that this institution would be charged with aiding the black market, and it is true that some speculators made a nice business for a short time of selling dollars to the National Bank and buying an equal amount for much less in the black market. It was not long, however, before the black market dollar rate began to rise, and the National Bank buying rate, which is based on a price index, rose with it. At the present time, the black market rate for the dollar is nearly 600,000 peng^o and the official rate about 280,000 peng^o. The foreign exchange market here centers upon the dollar, the gold Napoleon, and the Swiss franc. The National Bank does not even quote rates for pounds sterling which change hands in the black market at a considerable discount against the dollar. This is not a political manifestation but a practical one arising from the scarcity of demand which is discouraged by the difficulty of importing currency into Great Britain.

Aside from creating temporary confusion, the chief result of the currency levy (sometimes referred to here as a capital levy, which of course it was not except upon holders of cash) appears to have been to make the public more uneasy than before about its money, and more anxious than ever to translate cash into "real" values. This has aggravated the already severe shortage of goods. As in every inflation, a group of speculators is getting rich on the misfortunes of others. That their operations are of sufficient size to have a controlling effect on the black foreign exchange market is indicated by the temporary drop in the dollar rate which attended the news that UNRRA had agreed to send supplies to Hungary. However, so long as basic necessities of life

are in critically short supply, and so long as Government expenditures must be met to the extent of 95 per cent from advances by the National Bank, there seems little chance that an end can be put to inflation in this country.

There have been two other recent decrees of the Hungarian Government in the economic field which are of interest. The first of these, the rent tax, is an effort to increase the Government tax revenue and lessen dependence upon borrowing. Rents here are strictly controlled and have been ridiculously low. There were increases by decree at least twice in 1945, but these were inconsequential in comparison with the new rent tax which ranges from 200 to 1,000 times the amount of the rent. It must be paid by the tenant, not the landlord, except in the case of workers when it must be paid by their employers. The percentage of the tax is graduated according to the basic rent, going up as the rent goes up, and is higher for shops and business establishments. A surtax is added in the event that a dwelling is occupied by less than theoretical capacity, and a discount allowed for extra-dense population per room. This standard is based on the number of people while occupancy regulations are based on family units. Thus, each family is supposed to occupy only one room--kitchens, baths, halls excepted--with an extra room permitted for those who must receive clients or patients in the course of their business. The Housing Authority may install homeless persons in any excess rooms, and to avoid having to take in strangers, people with large homes have tried to double up with friends. Some device such as this is necessary in Budapest where the proportion of dwelling places destroyed or uninhabitable is large. In view of the present crowding, it is unlikely that the surtax will be applicable to any great extent. The first installment of the rent tax must be paid by January 20; estimates of the amount it will bring in are not available.

A second new regulation is an echo of earlier Hungarian economic history. After the last war, a "thrift crown" was used here as a unit of account, its value changing according to an index of prices and foreign exchange rates. In 1931, a "gold pengö" was established but never given real effect; the relation to the currency pengö, originally set at 1:1, was supposed to fluctuate inversely to the value of the non-gold pengö, but no change was ever made. This time, they have the "tax pengö" or "adópengö," created January 2 with a relation to the currency pengö of 1:1. This has now (January 17) been raised to 1:1.15 on the basis of some price index, possibly the one used by the National Bank in setting foreign exchange rates. Taxes must be paid in this unit--that is, the tax is assessed in pengö and paid at the rate in effect for tax pengö on the date of payment. Bank time deposits and bank loans may be made in this unit. Banks are making both kinds of loans, charging interest at an annual rate of 20 - 30 per cent (no loans are made for more than three months) on tax-pengö loans, and the "day money" rate of interest, now about 10 - 15 per cent a week, for others. The National Bank, however, will discount only paper expressed in tax pengö. This device may help to stabilize business operations temporarily but of course it does not attack the basic causes of the inflation which has gained such tremendous momentum.

Effect of Income Changes on American
Invisible Imports

Randall Hinshaw

In a previous article, it was shown that changes in the level of American income affect, in a consistent fashion, not only the total volume of commodity imports but the volume of various types of commodity imports as well.^{1/} In the present paper, we shall examine whether this is also true of the so-called invisible imports.

In the American case, the two most important invisible imports (accounting for virtually the total) are (1) expenditures on foreign shipping and (2) expenditures of American tourists abroad. When either of these variables is plotted against American national income, a positive correlation is readily apparent, but the data are of such a character as to suggest that a lag may be involved. To test this presumption, each of the two variables was correlated with the income figures of the preceding year. The result in both cases was a substantially higher correlation. The latter correlations are plotted in Charts 7 and 8.^{2/} In these charts, the variables are expressed as indexes on a 1937 base. None of the series are corrected for price changes, since no index is available which could be used to make the desired correction in either shipping or tourist expenditures.

The charts show clearly that, with the assumed one-year lag, American expenditures on foreign shipping and on foreign travel respond in a consistent way to changes in the level of American income. In the case of foreign travel, however, the regression is not linear, but curves upward, indicating that at higher levels of income, a larger proportion of an increase in income is spent by American tourists abroad. This is entirely in accord with what would be expected on the basis of a priori reasoning. Since foreign travel is decidedly a luxury, it is reasonable to suppose that, as national income expands, the fraction of an increment of income devoted to foreign travel also grows larger. Thus, instead of attempting to fit a straight line to the data, a logarithmic curve was computed by the method of least squares. This curve fits the scatter beautifully, as Chart 8 shows.

The average income elasticity of demand for foreign shipping, as computed from the data for the period covered, is 1.4, indicating that, within the range of observations, a rise in income is accompanied by a considerably more than proportionate rise in expenditures on foreign shipping. In the case of foreign travel, the computed average income elasticity of demand, within the range of the data, is a little lower (1.2), but since the fraction of an increment of income spent on foreign travel increases as income expands, the income elasticity of demand for foreign travel rises very sharply with a rise in income.

^{1/} Randall Hinshaw, "Effect of Income Changes on American Imports," Review of Foreign Developments, January 28, 1946.

^{2/} These charts are numbered so as to follow the six charts in the preceding article. The dates on Charts 7 and 8 refer to the income figures, which are associated with the shipping or travel figures for the year following.

CHART 7

ANNUAL INDEX FIGURES, 1937 = 100

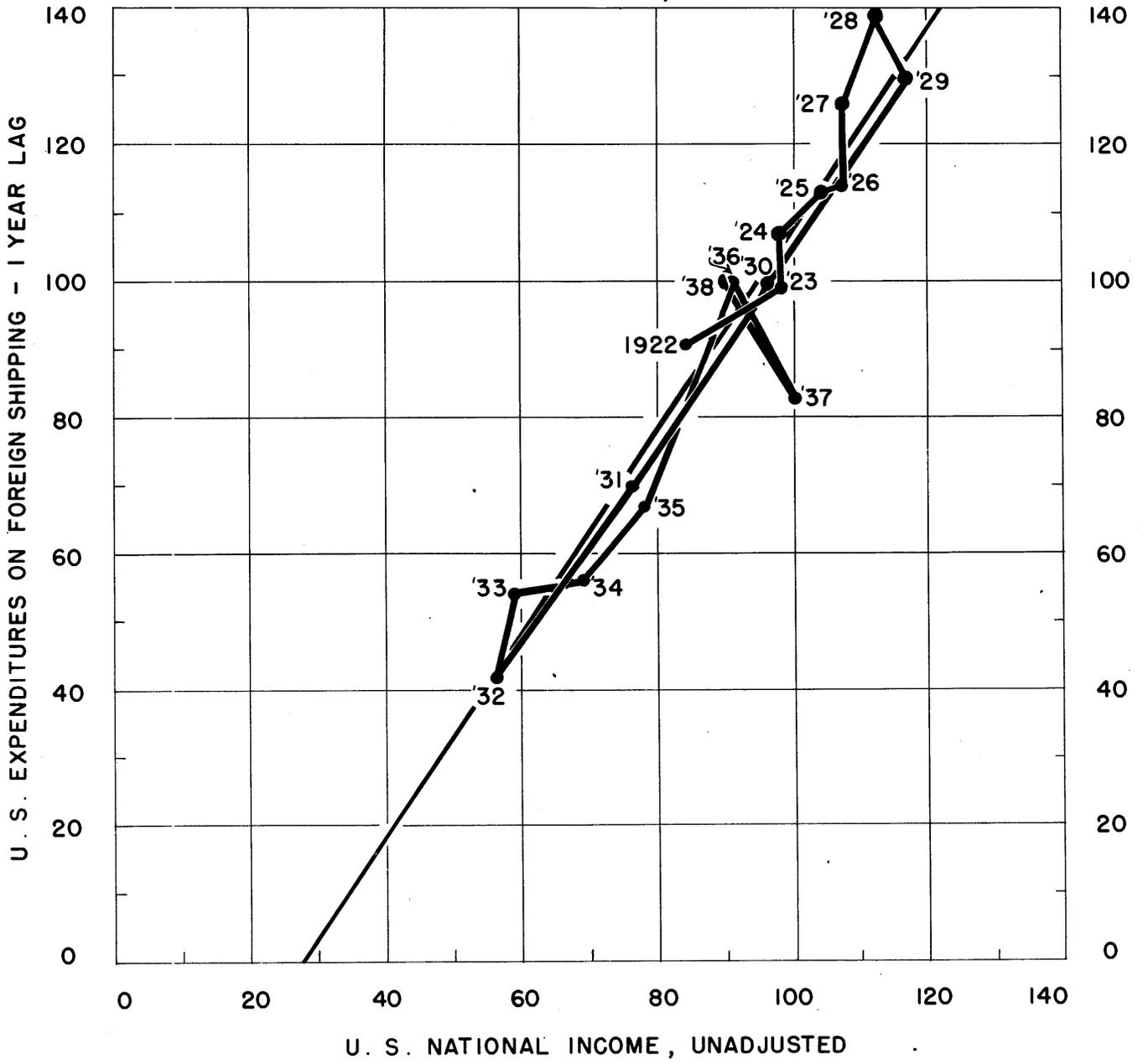
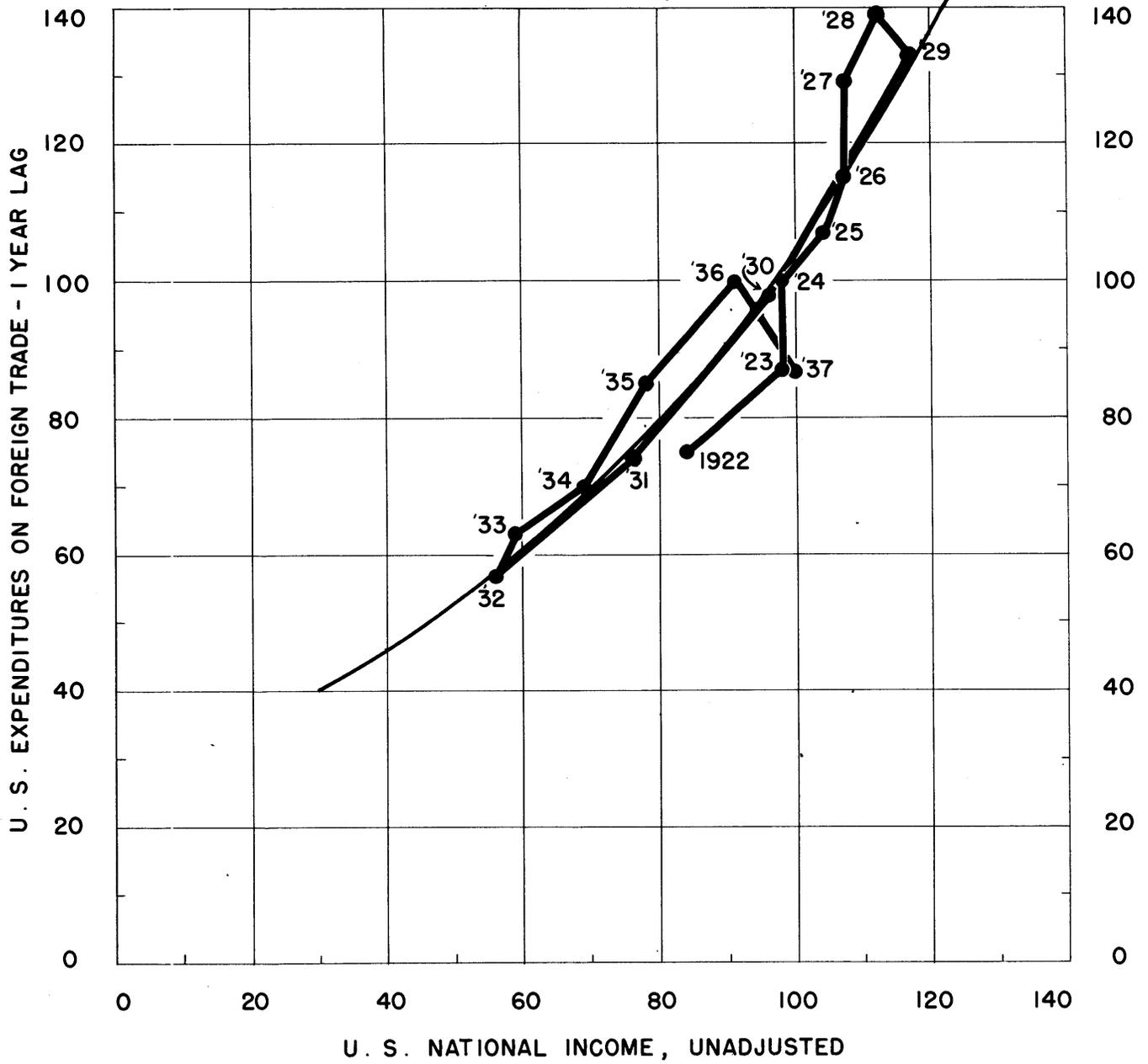


CHART 8

ANNUAL INDEX FIGURES, 1937 = 100



Estimates based on extrapolation are always precarious, and especially is this true where it is a rapidly ascending curve that is being extrapolated. Nevertheless, it is interesting to see what results are obtained when the regression equations computed in this study are used to estimate foreign shipping and travel expenditures at levels of income higher than any attained before the war.^{1/} Such estimates are supplied in the following table.

ESTIMATED AMERICAN EXPENDITURES ON FOREIGN SHIPPING
AND TRAVEL AT DIFFERENT LEVELS OF INCOME
(Millions of dollars)

<u>National Income</u>	<u>Shipping Expenditures</u>	<u>Travel Expenditures</u>	<u>Total</u>
80,000	457	425	882
100,000	609	619	1,228
120,000	761	905	1,666
140,000	913	1,319	2,232
160,000	1,065	1,921	2,986

Strictly speaking, the foregoing estimates refer to the year following the attainment of a given level of income. It can be seen from this table that tourist expenditures, as estimated by this method, increase very sharply with a rise in income. At a national income of 80 billion dollars, a level slightly below that of 1929, estimated tourist expenditures (the following year) are 425 million dollars; at a national income of 160 billion dollars, estimated tourist expenditures amount to 1,921 million dollars. That is to say, a doubling of national income increases estimated tourist expenditures by four and a half times.

Since the data used in these estimates have not been adjusted for price changes, the projections for invisible imports are not directly comparable with the projections for commodity imports included in the earlier article. However, a national money income of 160 billion dollars (at the prices estimated to accompany such income) most nearly corresponds to the level of real income previously assumed to coincide with full employment. At this level of income, estimated expenditures on foreign shipping and on foreign travel amount to a total of 3.0 billion dollars. If this is added to the estimated 7.7 billion dollars of commodity imports at full employment, we obtain an estimate of 10.7 billion dollars annually supplied to foreign countries from these three sources.^{2/} In relation to previous experience, this is a very large magnitude. The corresponding total for the boom year 1929 was only half as large (5.4 billion dollars), and for the depression year 1932 was only 1.8 billion dollars.

^{1/} The shipping projections should be regarded with a high degree of skepticism because of the radical changes since 1939 in the world shipping situation (notably in the supply of American vessels).

^{2/} During the period 1920-39, commodity imports plus expenditures on foreign shipping and travel accounted for 83 per cent of the debit items in the American balance of payments on current account.

No attempt has been made in these studies to estimate the remaining items in the balance of payments on current account. Of the debit items not included, the most important category embraces gifts to foreign persons and institutions. During the period 1920-39, such contributions averaged 331 million dollars annually. Gifts to foreign countries are not highly correlated with national income. They reached a high level during the 'twenties, dropped to less than half this level during the depression, and showed little if any tendency to recover. (Gifts abroad actually were lower in 1937 than in 1932 and 1933.) Since the correlation between American income and American gifts abroad is not high, there appears to be no basis for even a rough estimate of such gifts at the income levels expected to prevail in the future.

Exchange Rates of Balkan Currencies

J.H.F.

The Yugoslav National Bank has promulgated its official rates for the purchase and sale of foreign exchange. In terms of United States currency, the dinar remains at two cents although according to newspapers reports a "tolerated free market rate" of 0.4 cent and less is quoted in Belgrade. More important is the fact that for the first time the currencies of other Balkan countries are quoted in a form which makes possible the computation of dollar cross-rates. The Rumanian leu is quoted at 0.01 dinar, equivalent to 0.02 cent at the official dinar-dollar rate or about one-twenty-fifth of the latest official Rumanian rate. The Albanian franc is quoted at 2.5 dinars, equivalent to five cents, which is less than one-sixth of the pre-war rate, but seven times as much as the latest official Albanian rate. The Bulgarian lev is quoted at 0.1 dinar, equivalent to 0.2 cent or less than one-fourth of the latest official Bulgarian rate. The rate for the Albanian franc may have been influenced by political considerations, and may represent a considerable overvaluation of that currency, but the Rumanian and Bulgarian currencies are probably valued at approximately their purchasing power parities since the Yugoslav Government is trying to foster trade with these countries and has no apparent reason for impeding that commerce by artificial exchange rates. In estimating the dollar values of these currencies, it would probably be wise to take as the basis the "free market" rather than the official dollar value of the dinar, which would give rates only one-fifth of those quoted above. In any case, the quotations give at least an indication of the magnitude of the currency depreciation in Rumania and Bulgaria--information which is the more valuable since direct news from these countries is still virtually unobtainable.

Lend-Lease "Pipeline" Agreement with Russia

C.R.H.

A brief announcement on October 15 referred to the conclusion of an agreement with the U.S.S.R. for the disposal of a maximum of 400 million dollars worth of supplies originally destined for that country under the lend-lease program, but not delivered prior to the virtual cessation of straight lend-lease in September of 1945. More complete details of that agreement have now been released in the President's Twenty First Report to Congress on Lend-Lease Operations. Since the terms of this agreement differ somewhat from those of other arrangements covering disposal of similar "pipeline" goods to other countries, a brief summary may be in order. It is possible also that the terms which proved acceptable to both countries in this instance may set the pattern for future loans to the Soviet Union. The question of a long-term reconstruction loan to Russia was reintroduced into public discussion in last Sunday's release to the press of portions of a pending Colmer Committee study. Moreover, the interest of the Soviet Union in American surpluses abroad has been evidenced by the visit of a Russian mission to the Paris depot for such stocks.

Schedule II, annexed to the agreement,^{1/} contains the principal financial terms. Of greatest general interest, perhaps, is the following stipulation:

"If by agreement of both Governments it is determined that, because of adverse economic conditions arising during the course of payment, the payment of a due installment would not be in the joint interest of the United States and the Union of Soviet Socialist Republics, payment may be postponed for an agreed upon period."

Both the position of this paragraph and its wording indicate that it applies only to amortization payments. This is the first governmental loan in which the United States has provided for a conditional postponement of scheduled amortization payments; the financial agreement with the United Kingdom, now awaiting Congressional approval, provides for conditional waiver of interest payments.

The schedule of capital repayments is unusual. Without extending the thirty-year repayment period offered to all countries in connection with purchases of lend-lease pipeline goods, the agreement provides that the first scheduled capital installment shall not become due until July 1, 1954. Beginning on that date, capital repayments will continue for twenty-two years in accordance with the following schedule of annual installments:^{2/}

- 4 installments each equal to 2.5 per cent of the capital amount;
- 4 installments each equal to 3.5 per cent of the capital amount;
- 4 installments each equal to 4.5 per cent of the capital amount;
- 4 installments each equal to 5.5 per cent of the capital amount;
- 6 installments each equal to 6.0 per cent of the capital amount.

^{1/} Schedule I, which contains detailed information concerning the specific goods to be supplied to Russia, is not printed in the President's Report.

^{2/} The Soviet Union retains the right to anticipate the payment of all or part of any of the installments.

Interest will accrue at the rate of 2-3/8 per cent per annum from July 1, 1946, on the unpaid balance of the Soviet indebtedness and will be payable annually beginning July 1, 1947. This is the interest rate extended in connection with 3c lend-lease agreements signed while the lend-lease program was in operation and offered to all countries purchasing pipeline supplies.

Schedule II contains detailed provisions concerning the pricing of the goods to be sold to the U.S.S.R. The Soviet Union is to pay the "fair value of the articles" plus (for nonfoodstuffs) the costs of storage, inland transportation, inland and port accessorial charges incurred subsequent to the transfer of title to the Soviet Union. For foodstuffs, the latter group of costs will be included in the "fair value of the articles."

The "fair value of the articles" in turn is defined for non-foodstuffs as the contract price less 10 per cent;^{1/} for foodstuffs, the fair value means the price at which the United States Government sells similar articles in like quantities to other foreign governments during the same period.

A final financial provision may be mentioned. This occurs in Article II of the agreement itself and provides assurance to the Soviet Union that gold will remain an acceptable means of payment against the Russian obligation throughout the life of the loan. The provision follows:

"The obligation of the Government of the Union of Soviet Socialist Republics to make payment in dollars in accordance with the terms of this agreement may be discharged by the delivery of gold, which will be valued at the buying price for gold provided in the provisional regulations issued under the Gold Reserve Act of 1934 as the same may be in effect at the time of each delivery."

^{1/} The contract price for nonfoodstuffs is in all cases to be the quoted or computed price "f.o.b. point of origin," i.e., the factory at which produced; and title and risk of loss will be transferred at that point.

Switzerland's Foreign Lending in the Post-War Period

R. E.

The following table is a preliminary summary of the available information with regard to Swiss foreign lending in the post-war period. This information is not necessarily complete.

All the credits listed are presumably short-term or medium-term credits. It is believed that the private credits, as shown below, are being granted by a syndicate of three Swiss banks: the Swiss Bank Corporation, Cr dit Suisse, and the Union Bank of Switzerland. It appears that the syndicate was formed as early as 1944. These credits, however, are covered by a guarantee of the Swiss Government. The Swiss Socialists attempted to make the Government go beyond the guarantee to the Banking Syndicate, and to control more actively the export of private

capital from Switzerland. The motion to this effect, however, was defeated in the National Council.

On the basis of the information so far available, it is not yet possible to estimate the total volume of foreign lending which Switzerland may undertake during the period of the European reconstruction. It would seem from recent press comments that the Swiss public views the foreign lending with favor because it encourages Swiss exports, and facilitates resumption of trading relations which have been interrupted during the war years. On the other hand, adverse features of the lending program are also mentioned. The risk involved is considered to be substantial. Moreover, the Swiss express some apprehension lest excessive foreign purchases should lead to an unjustified expansion of certain industries working for exports. Overexpansion, it is argued, will require painful readjustments when the present export boom has subsided and when it becomes necessary for Switzerland to increase imports in accordance with her creditor position.

SWISS FOREIGN CREDITS

	<u>Government Credits</u>		<u>Private Credits</u>		<u>Total</u>	
	Swiss		Swiss		Swiss	
	<u>francs</u>	<u>Dollars</u>	<u>francs</u>	<u>Dollars</u>	<u>francs</u>	<u>Dollars</u>
	(In millions)		(In millions)		(In millions)	
a) <u>Granted</u>						
France	1/ 250	58.1	-	-	250	58.1
Belgium	2/ 50	11.6	-	-	50	11.6
Netherlands	3/ 25	5.8	4/ 50	11.6	75	17.4
Sub-total	325	75.5	50	11.6	375	87.1
b) <u>Under Negotiation</u>						
Netherlands	-	-	5/ 40	9.3	40	9.3
Italy	6/ 80	18.6	-	-	80	18.6
Norway	7/ 20	4.7	8/ 30	7.0	50	11.7
United Kingdom	-	-	9/ 100	23.3	100	23.3
Finland	10/ 35	8.1	-	-	35	8.1
Sub-total	135	31.4	170	39.6	305	71.0
Total	460	106.9	220	51.2	680	158.1

- 1/ Credit opened in April 1945 as a reciprocal intergovernment credit; first part utilized during the summer; second half made available to France in November 1945. Rate of interest not known.
- 2/ Credit opened in July 1945 by Swiss Government. Purpose: purchase of goods and payment of interest on old loans.
- 3/ Credit opened in October 1945 by Swiss Government. Interest rate $1\frac{1}{2}$ per cent. Purpose: financing of Dutch payments in Switzerland for Legation and Consular expenditure, Swiss Red Cross advances, and others.
- 4/ Commercial loan at $3\frac{1}{4}$ - 4 per cent interest.
- 5/ Under discussion; purpose: purchase of Swiss goods and payment of interest on old loans.
- 6/ Credit planned under Payment Agreement with Italy, rate of interest to be $1\frac{1}{2}$ per cent. So far plan blocked by the Allies. Originally the Italians asked for 350 million francs.
- 7/ Government loan under discussion; rate of interest $1\frac{1}{2}$ - 3 per cent.
- 8/ Private loan under discussion; rate of interest $3\frac{3}{4}$ - 4 per cent.
- 9/ Private loan under discussion.
- 10/ Government loan under discussion.

India Calls In Large Denomination Notes

J. E.

In an effort to smoke out black marketeers and tax evaders and to eliminate unsound practices in banking, the Government of India last month issued a series of three ordinances designed to withdraw all large denomination notes from circulation and to subject all banks to inspection by the Reserve Bank.

Large-scale black market operators, in India as in other countries, have been concealing their transactions by making them in cash, using large denomination notes. In addition, there has been widespread evasion of income taxes both through failure to report and through the stratagem of keeping deposits in those Indian states where there are no taxes, meanwhile borrowing from banks in Bombay and charging the interest on the loans as business expense for tax purposes. This practice, known as the "Benami" operation, has added to the unhealthy inflation of credit in British India, where deposit liabilities of scheduled banks rose from Rs. 245 crores in August 1939 to 584 in August 1945. In order to stop these and other practices, the Government is now trying to control both the currency and the banking system more closely.

Two ordinances on January 12 were directed against the large denomination notes. The first one, made public early in the morning of the 12th, made the day a bank holiday and required all banks and government treasuries to declare their holdings of all notes of 100 rupees and above by 3 p.m. of that day. The Government could thus compare the amount of such notes held by banks and treasuries with the total circulation.

The second ordinance, which came late on the same day, provided for the retirement of all 500, 1,000, and 10,000 rupee notes. These notes immediately ceased to be legal tender. Banks and government treasuries were permitted to exchange them for 100 rupee notes or for credits with the Reserve Bank of India. Individuals were given ten days within which to exchange their notes. In so doing, however, they were required to submit declarations in which they were obliged to state their income tax bracket, the nature of their businesses, their salaries, the denominations of the notes tendered, how they were acquired, and why they were being held. To prevent evasion, the person signing the declaration was deemed the owner of the notes, particularly for tax purposes.

The third ordinance, issued on January 14, gave the Government power to direct the Reserve Bank to investigate the affairs of any bank and to take corrective action if investigation warranted. The ordinance was aimed not only at the "Benami" operation, but also at such abuses as granting unsecured loans to persons connected with the management, acquiring control of non-banking companies, and expanding branch banking indiscriminately.

The total note circulation in India at the time of the ordinances was about Rs. 1,200 crores, ¹/_{at least 12½} per cent of which was

¹ One crore equals 10,000,000 rupees. The rupee is now quoted at U.S. \$0.3035.

estimated to be in notes of more than 100 rupees. Large denomination notes immediately fell to a discount of from 40 to 60 per cent in spite of the fact that operations in them were illegal. There were also reports that large quantities of notes were being exported, both to the Indian states, where the ordinances were not in effect, and abroad. Regulations for dealing with notes thereafter brought into India were not immediately promulgated.

Although the Government has assured bona fide holders that they will lose nothing from the demonetization of the large notes, the nationalist press has expressed concern for illiterate holders and has also voiced a fear that inflation will be accentuated by the loss of confidence in the currency and banking systems.

The withdrawal of large notes in India has been accompanied by harsher regulations than the same move in Great Britain on May 1 of last year: the British were not required to furnish declarations, and the right of redemption has been continuously maintained. It is less drastic, however, than if the notes had been required to be turned in to blocked accounts, as has been done in several Continental countries. The indication is quite clear, therefore, that the Indian Government does not intend to use a forced contraction of the money supply as a primary weapon against inflation, but chooses rather to continue to rely on direct controls.