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

REVIEW OF FOREIGN DEVELOPMENTS

May 20, 1946

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Banking Reform in Argentina - A 100% Money Experiment

Robert Triffin

Following closely upon its recent nationalization of the Central Bank,[1] the expiring Provisional Government of President Farrell released last month another financial bombshell. Decree No. 1155 of April 1946 does not nationalize commercial or investment banks in Argentina, but introduces even more revolutionary innovations, which go to the very core of traditional monetary and banking mechanisms.

The Decree institutes, in effect, a 100 per cent reserve system which bears a close resemblance to the 100 per cent money mechanism of Professor Fisher and the Chicago group. The experiment, applied for the first time in modern history to a highly developed financial community, will be followed with the utmost interest, although of course there is no indication that it was inspired by motives, or will be used for purposes, identical to those prompting the majority of the 100 per cent money advocates.

I shall attempt to review briefly the essential provisions of the new decree, the arguments officially advanced in favor of the reform, and some other considerations essential for a balanced appraisal of the legislation.

1/ See Review of Foreign Developments, April 8, 1946.

I. Essential Provisions of the Reform

The substantive articles of the Decree are worth quoting in full:

> Article 1. - As from the date of the present Decree-law, the Nation guarantees all deposits of third parties in official, private, and mixed banks established in the country, whether on current account, savings account or time, or under any other denomination constituting, in the judgment of the Central Bank of the Argentine Republic, a deposit contract, with or without interest. As a consequence of this guarantee, the banking institutions shall proceed, from this same date, to register in the name of the Central Bank of the Argentine Republic the deposits mentioned above, through the pertinent accounting procedures, as well as the movements in the respective accounts originating in cancellations, withdrawals, transfers, or new deposits. To this effect, the banks are given legal mandate to act as direct agents of the Central Bank of the Argentine Republic, with the responsibilities and duties pertaining to this character.
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> Article 2. - The Central Bank of the Argentine Republic shall defray the financial costs or interest to be paid to the depositors, and shall compensate the banks, in agreement with them, for the administrative costs of the service.
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> Article 3. - The banks shall not draw on nor use the deposits referred to in this Decree, except upon written authorization of the Central Bank of the Argentine Republic, but shall continue to attend to the withdrawals and movements ordered by the depositors. As legal mandatories of the Central Bank, the banks shall maintain attention and accomodation of the depositors in the same form and according to the same rules now prevailing.
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> Article 4. - For the continuation of their operations of discount and investment, the banks shall make use of their own capital and surplus funds and may rediscount their portfolios in the Central Bank of the Argentine Republic within the limits and under the conditions which the Bank establishes, in accordance with the state of the money market and the liquidity of each banking establishment.

To this effect the Central Bank of the Argentine Republic shall determine lines of credit or special qualifications with relation to each bank, for the rediscount of their portfolio, credits on current account, investments in securities and other normal banking operations. The Central Bank may also establish, in accordance with the requirements of the various sectors of production and with the character of the deposits received by each bank, in addition to the qualification for the rediscount of short-term operations, additional lines of rediscount operations of a medium- and long-term character secured with real or other sufficient guarantees at the discretion of the Central Bank.

Article 5. - When there occurs, in the judgment of the Central Bank, justified reasons for improving the liquidity of the banks, the Central Bank may take in pledge national, municipal, or provincial securities quoted in the stock exchanges of the country, under the conditions and terms which the Central Bank shall establish.

Article 6. - The Central Bank shall fix the rates of interest on the rediscounts referred to in Article 4 and the pledges alluded to in Article 5. This determination shall take into account the state of the money market and the policy of economic development through credit extension, and may consist in differential rates in accordance with the purpose of the loans effected by the banks. It shall also determine the rates applicable to the use of funds for credits on current account and investments.

Article 7. - The regulation of the present Decree-law shall be presented to the Executive Power for its approval, together with the projects and regulations referred to in Article 15 of Decree-law No. 8503/46 /Nationalization of the Central Bank/.

Article 8. - Until such time as the Executive Power approves the regulations referred to in the preceding article, the Central Bank of the Argentine Republic shall immediately apply the present Decree-law in conformity with the needs, systems, procedures, and conventions which it considers necessary and useful to that end.

The significance of the decree cannot be fully gauged until the regulations announced in Article 7 are promulgated and, most of all, until the policy of the Central Bank is made clear through actual operation, as well as through broad declarations of intent. From the decree itself, however, and from the accompanying official report, the following outline emerges with a sufficient degree of definiteness.

1. All bank deposits (demand, time, and savings) are to be guaranteed by the State and to be held by the banks only for the account of the Central Bank. The banks will continue to handle the accounts but only as agents of the Central Bank which may freely determine the use of the funds, except that depositors retain the same rights as they now enjoy with respect to transfers, withdrawals, etc. The Central Bank will defray the costs of handling the deposits and reimburse the banks for interest paid to the depositors.

2. This deprives the banks of their main source of funds for the granting of loans and the purchase of securities and, in theory, limits them in those operations to the use of their own capital and surplus. Total capital and surplus funds of the banks in Argentina amount at present to about 800 million pesos[1/] while bank loans and investments are nearly ten times as high, totalling about 7 billion pesos. Thus, a large portion of the deposits are actually immobilized in loans and investments and, to that extent, could not, in fact, be immediately transferred in cash to the Central Bank.

Initially, the Central Bank will agree with the various banks to consider that part of their loans and investments which exceeds their capital and surplus funds as rediscounted by the Central Bank itself, at rates to be determined by it. "An account will be opened between the Central Bank and each bank, registering on one side the amount by which the bank's portfolio exceeds its capital and surplus funds, and on the other, the amount of deposits--now at the order of the Central Bank--which the bank has used or needs to use, in the judgment of the Central Bank, to maintain, continue, or increase these operations."

Later on, the Central Bank will investigate the real value of the banks' portfolios and will establish for each bank maximum limits, subject to review, within which loans and investments will be admitted for rediscount. Rediscounting will necessarily extend not only to short-term paper, but also to medium- and long-term loans. Such loans, however, will have to conform to special conditions imposed by the Central Bank as to the purposes, guarantees, aggregate maxima, etc., applying to each type of operation.

II. Official Defense of the Reform

The Decree-law is preceded by a very lengthy and well-written report justifying the measures taken by the Government.

The first argument is a very general one, derived from the fact that deposits play today practically the same monetary role as money proper. The report recalls the observation made in 1935 on the occasion of the presentation to Congress of the General Banking Law: "Not only do they [the banks] receive the deposits of large masses of the population, which entrust their savings to them; they also perform a monetary function of fundamental importance for the collectivity. When the banks make loans, they also create deposits which, when drawn upon by checks, play the same monetary function as currency itself, and tend more and more to exceed it in importance."

1/ The peso is currently worth about 25 United States cents.

The report concludes that operations of this nature are necessarily affected with a high degree of public interest, and that the State must accept responsibility for strict control in order to preserve the general interest.

Secondly, and closely related to the first point, it is argued that the new banking organization is necessary to permit adequate quantitative control of the means of payment and their adaptation to actual needs. The war-time monetary experience of Argentina is cited to demonstrate how a favorable balance of payments produces a great increase in banking liquidity and leads to a continuous expansion of monetary circulation (money proper and deposits). The report recognizes that great efforts were made by the Central Bank over the past ten years to control monetary circulation. It must be remembered, however, that the Organic Law of the Bank of Argentina did not provide it with sufficient weapons in this respect. The modern instrument of flexible reserve requirements, especially, was denied to the Bank, and reserve requirements were of a rigid character which made them unfit for the purposes of monetary regulation. In order to obviate this weakness, the Central Bank developed procedures of its own, based largely on the issue by the Bank of participation or custody certificates, designed to withdraw from circulation excess funds held by the banks or the public. In addition, the Central Bank used its moral influence upon the banks to prevent excessive credit expansion in periods of increasing liquidity, and the banks used also part of their cash for purchases of Government bonds and other official securities.

That these measures failed fully to attain their purpose has been evidenced by the continuous and large increase in monetary circulation over the past five years. The official report on the new law points out two reasons for this limited success. The first is that the balance of payment surpluses were so large as to make a full stabilization policy impossible of achievement. The second is that the purchase of Government bonds by the banks did not effectively sterilize a corresponding amount of banking resources since the proceeds of the issues were then used by the Government and found their way back into private deposits with the banks. This second argument does indeed constitute a condemnation of the Government's financial policies rather than of the policies of the banks. The large and continuous borrowings of the Government constituted, as pointed out on many occasions by the Central Bank, a major obstacle to monetary stabilization, since the Bank had to refrain from placing its own absorption paper in adequate amounts, for fear of depressing the market for Government securities and interfering with their flotation. Such an implication, however, is not drawn by the report.

Even if it had been fully effective, the absorption policy of the Central Bank was open to another objection, which is forcefully presented in the report. In order to prevent undue expansion by the banks, the Central Bank had to sell them interest-earning certificates which increased the banks' profits, while decreasing correspondingly the profits of the Central Bank and, indirectly, of the National Treasury.

In fact, the Central Bank experienced considerable difficulty in financing its own operations, since rediscounts have been practically nil for many years and since the Bank has been obliged, on the contrary, to pay interest on its sterilization paper. In order to solve this difficulty, an arrangement was made by which the National Treasury paid interest to the Central Bank on a very large part of the Bank's gold holdings. It is not surprising to find that the Government finally refused to finance a continuation of such policies.

The new banking statute undoubtedly gives the Central Bank all the weapons which it might wish in order to check any expansionary action on the part of the private banks, since, in principle, the banks will now have to maintain 100 per cent reserves against all their deposits and can expand credit only after they have received funds lent to them by the Central Bank.

A third argument put forth in favor of the new statute is that it will permit the Central Bank to apply selective credit controls. This is also true since the Central Bank will be free to place any conditions which it wishes on the use by the banks of the funds which it makes available to them. The control of the Central Bank is indirect insofar as it acts merely through differential rediscount rates. It is a direct control insofar as the Central Bank can determine the absolute amount of its rediscounts and can dictate the maturities, guarantees, and other conditions of eligibility of medium- and long-term loans.

Finally, the report argues very strongly that the new system is needed to assure full protection to the depositors. Indeed the Central Bank will now be in a position to control practically all bank loans and investments and, in addition, the national Government itself will guarantee fully the repayment of deposits. It may be questioned, however, whether the dangers and insecurity of the previous system were as serious as the report indicates.

III. General Comments

There is a great deal of strength in the official argument that the previous system of monetary controls was inadequate and costly. The positive conclusions drawn by the Government in favor of the new regime are, however, considerably weaker. Less radical reforms could have solved the problem nearly as well, while giving less leeway for arbitrary use of the controls for political purposes.

The new system of regulations embodies the most complete control over money and credit which has ever been established in any country. The actual results of the reform will depend entirely on the wisdom and honesty with which it is applied. It may be significant that the report denies any intention of using the reform for deflationary or restrictive policies. On the contrary, the emphasis is placed on economic expansion and the full utilization of credit for developmental purposes. In view of the present inflationary trend in Argentina, such an emphasis is somewhat disquieting.

The needs of the Government for additional financing, both for current expenditures and for the maintenance of the official bond market, are very great. The absence of any enlargement of the powers of the Central Bank to lend assistance to the Government was, to the practical observer, a puzzling feature of the recent decree nationalizing the Central Bank. The official report accompanying the present law points out that the new law does not introduce any further changes in this respect and that the Central Bank's loans to the Government are still as narrowly limited as they have been since 1935. Strictly speaking this is true, but it becomes totally irrelevant under a banking system which gives to the Central Bank full control over the operations of the private banks themselves. The Central Bank will obviously be in a position to dictate to the commercial banks (official, mixed, and private) the types of loans they have to make if they wish to operate at all. Thus, for example, the Central Bank may expand its line of credit to a bank in order to permit it to lend to the Government,1/ but refuse this assistance to a bank which wishes to use it for loans to private clients.

IV. Conclusion

The new Argentine Decree-law on the control of deposit banking introduces the most radical changes in the traditional mechanism of bank credit. While the private banking system is not nationalized in name, the new law contemplates as complete a transfer of power from private institutions to a public body as any advocate of nationalization might wish for. Moreover, the new law will give the Central Bank full control over bank profits, since the Central Bank will be able to dictate both the interest rates to be charged by the banks, and its own rediscount rates on the banks' portfolios.

Scrupulously and intelligently used, the new law would help immensely in the stabilization of money and credit in Argentina. More moderate reforms directed at the same objective had long been urged by the Central Bank, before its recent nationalization. The official report on the law, however, is repeatedly critical of previous Central Bank policies. This by itself would be disquieting in view of the high standards of policy and management generally and justly credited to the Central Bank, and of the inflationary record of the Government in recent years. Even more disturbing is the current and pressing need for funds on the part of the Government, and the likelihood that the new powers are designed in part, and will largely be used, to permit a continuation of inflationary Government spending.

1/ Article 5 of the new decree is apparently designed to remove, in practice, the barriers on such loans erected in the organic central banking law of 1935.

Belgian-Netherlands Customs Union

J. Herbert Furth

The Netherlands and the Belgian-Luxembourg Economic Union have agreed to put into operation the customs union, which was proposed by their Governments-in-Exile in a treaty concluded in London on September 5, 1944. The exact date and the conditions under which the customs union will be established have not yet been made public, but it is expected that the union will be accomplished by the end of 1946.

The basic treaty provides for the abolition of all customs barriers between the territories concerned and for the adoption of identical duties in relation to third countries. It also provides for the establishment of three administrative commissions, charged with the formulation of proposals for the necessary unification of legislation, the coordination of licenses and export and import quotas, and the coordination of relations with third powers, respectively. The first of those commissions was appointed in April 1946. Originally, the treaty was to have entered into force immediately after the reinstallationof the governments in the liberated countries, but the period was prolonged by tacit understanding.

Both the Netherlands and the Belgian-Luxembourg Economic Union are among the world's leading trading nations. In 1937, the Netherlands had imports of 754 million dollars and exports of 563 million dollars, and Belgium-Luxembourg imports of 928 million dollars and exports of 851 million dollars. Trade between these two territories represented approximately one-tenth of the total. If this trade is excluded, the foreign trade of the two territories combined amounted to 5.9 per cent of world imports and 5.3 per cent of world exports, a share of world trade greater than that enjoyed by France or Japan and exceeded only by the pre-war shares of the United Kingdom, the United States, and Germany.

The international trade situation of the two territories is similar in regard to imports, both of the territories relying upon imported raw materials for the bulk of their industries, but somewhat dissimilar in regard to exports. Both countries import large quantities of wheat, corn, textile fibers, wood, coal, metal ores, iron, copper, tin, and machinery. Both countries export textile fabrics, coal, refined metals, machinery, fertilizers, and precious stones. In addition, Belgium-Luxembourg exports flax, wool, coal, and iron and steel, and the Netherlands dairy products, vegetables, flower bulbs, radios, ships, and vegetable oils. This reflects the differences in the domestic economic structure of the two territories, with Belgium-Luxembourg relying mainly upon its iron and steel, chemical, and textile industries, while the Netherlands is also a leading producer in the fields of horticulture, dairy farming, shipbuilding, and the electrical and margarine industries. Thus the economies of the two countries are to some extent complementary, but not to such a degree that they could disregard their primary dependence upon trade with third countries.

The abnormalities of the present transition period will make the task of setting up the union easier in some respects and more difficult in others. At present, both countries have a strong interest in stepping up imports in order to facilitate rehabilitation, and there will be less opposition to a lowering of tariff walls than in normal times. For instance, Belgian farmers can hardly object successfully to facilitating imports of vegetables and dairy products from Holland at a time when the scarcity of protective foodstuffs remains a main concern of the non-farm population, and the Netherlands textile interests can hardly protest the removal of barriers against the importation of Belgian cloth as long as only a fraction of the total demand for clothing can be satisfied. In reconstructing the war-shattered economies, both territories will be able to some extent to take into consideration the prospective tariff situation, and to avoid the reestablishment of industries that could not compete successfully with enterprises situated in another part of the new customs union.

On the other hand, prices and wages probably differ more between the territories today than they would in ordinary times. In the Netherlands, the cost of living has been kept relatively low by the use of Government subsidies for most necessities, and wages have been stabilized at about 150 per cent of the May 1940 level. In Belgium, the cost of living was until recently substantially increased by black-market prices, wages have risen to about 300 per cent of May 1940, and further wage increases have been prevented only by a Government promise to decrease prices by at least 10 per cent. It is doubtful how far the abolition of Government subsidies in the Netherlands will raise prices and wages since this measure will be counteracted in part by the increase in supplies. It is equally doubtful whether the Belgian Government will actually succeed in lowering prices and keeping wages from rising further. While differences in the standard of living, the efficiency of labor, and other traditional factors would permit maintenance of some wage and price differentials between the Netherlands and Belgium (witness the differentials between North and South in the United States), the present discrepancy would certainly constitute a disturbing factor.

The financial situation of the two territories is also quite dissimilar, in spite of the similarities in the currency reform measures applied in 1944-45. As compared to 1939, currency circulation has doubled in the Netherlands and tripled in Belgium. On the other hand, Government revenues for 1946 are estimated at around 220 per cent of pre-war in Belgium, but at about 360 per cent of pre-war in the Netherlands. Since the successful operation of a customs union between two partners of approximately the same economic weight requires a basic similarity of monetary and fiscal policy, these discrepancies will have to be reconciled in the near future. The different international economic situation of the two territories also must be taken into account. Belgium, owing mainly to the accumulation of dollars and sterling as the result of the prolonged stay of the Allied armies on Belgian territory, has ample supplies of foreign exchange with which to cover the expected deficit of 300 million dollars in its trade balance for 1946. The Netherlands, although before the war one of the most important creditor nations of the world, must cover a substantial portion of its expected trade deficit of 750 million dollars by foreign borrowing. Probably as the result of this discrepancy, the black-market value of the Netherlands guilder in relation to the Belgian franc is reported at only 60 per cent of the official rate, in spite of the higher price level prevailing in Belgium.

The proposed union would be even more significant than the importance of the two areas indicates if it were extended to embrace the Netherlands and Belgian overseas territories, which are among the richest sources of tropical raw materials in the world. Their inclusion would raise the 1937 figure of both exports and imports of the entire area (deducting the substantial trade between these territories and their mother countries) to 1.7 billion dollars. Since the leaders of the Indonesian independence movement have indicated that they want political rather than economic separation from the Netherlands, such a development does not appear improbable.

Another and vastly more extensive expansion would be the inclusion of France. This would double the 1937 foreign trade operations of the union (deducting the trade between the union members) and make them greater than those of the United States. While such a development is nowhere in sight, it should be remembered that the Belgian-Luxembourg Economic Union, the Netherlands, and France signed an economic pact on March 20, 1945, providing for mutual consultation and mutual aid in questions of international trade, rehabilitation, and "harmonization of production." The traditional protectionism of French economic policy does not point in the same direction as the traditional liberalism of the Low Countries. French fear of foreign competition might, however, be allayed if France should be given a decisive role in administering the Ruhr-Rhine industrial area. In that case, the prospect of being able to compete on almost equal terms with the United Kingdom and the United States might well induce France to make substantial concessions in return for the formation of a Western European economic bloc.

Such possibilities are a matter of mere speculation. But whatever the future may bring, the establishment of the customs union will probably be one of the great economic events of 1946. The decision of the new bloc, either to continue the liberal traditions of its members or to strive for a larger degree of self-sufficiency than the individual members could have hoped to achieve, may well be crucial for the future of world trade.

Agreement for Settlement of Turkey's Lend-Lease Account A.R.B.

An agreement was signed in Ankara on May 8, 1945, by the representatives of the United States and the Turkish Governments providing for the final settlement of Turkey's lend-lease account. The text of the agreement is not yet available, but according to official releases in this country Turkey undertakes to pay 4.5 million dollars in cash to ~~the~~ United States Government within thirty days, and receives full title to lend-lease equipment of a civilian nature now located in Turkey. The original cost of this equipment was 5.7 million dollars.

Military items still in the possession of the Turkish armed forces are not to be paid for, but are subject to the right of recapture, although the United States is reported to have stated in the agreement that it does not intend generally to exercise this right. The agreement was ratified by the Turkish National Assembly one day after its signing, Turkish officials expressing special pride in the fact that their country is the first to liquidate its lend-lease obligations by a cash settlement.

Turkey became eligible for lend-lease aid on November 7, 1941, as a result of a unilateral declaration by the President to that effect. The lend-lease master agreement was signed on February 23, 1945, coinciding with Turkey's declaration of war against Germany and Japan. During the period between November 7, 1941, and the termination of lend-lease, supplies of an aggregate value of 104 million dollars were shipped from the United States to Turkey. But the amount actually delivered was 64 million dollars, because of the rerouting of supplies to other areas in the Middle East. Adding to this sum the value of equipment transferred from the United States Middle East headquarters from time to time, the total value of United States lend-lease deliveries to Turkey stands at 90 million dollars. A great part of these deliveries consisted of military equipment which helped Turkey to modernize its army and increase its capacity to resist Axis pressure.

The Problem of the German Reich Debt

Paul Hermberg

The third Reich absorbed the bulk of German wealth accumulated in earlier periods and created during the era of Nazi domination. A part of German resources was used up in fighting the war, a second part was devastated by military action, and a third was consumed, destroyed, or removed as reparations by the occupying Allied powers. The loss of property, however, has not been acknowledged by the former owners, who continue to regard their various forms of claims against the broken Reich as valuable property. The most important groups of these paper claims are the following:

Claims based on	Estimated amount (In billions of Rm)
(1) Reich debt	400 - 450
(2) Fulfilled or current Reich contracts	30 - 40
(3) War damages	200 - 250
(4) Damages connected with occupation and reparation	
(a) In the four Zones of Occupation	40 - 100
(b) In territories from which Germans were expelled	30 - 60
	700 - 900

This amount has been estimated in a very rough manner; Reich debts have been assessed at nominal value and other claims at prices of 1938.

It is doubtful whether any consideration of justice dictates the granting of formal priority to one group of claims before the others, at least in connection with domestic claims; especially is there no reason for giving privileged treatment to claims based on Reich debt. When the bulk of the Reich paper originated, the debtor and the majority of the creditors were fully aware of its questionable character. The following investigation is limited to the official Reich debts not because they deserve a priority but because this type of debt must be handled with particular care to avoid creation of a new unbearable foreign indebtedness. The pre-war foreign debt of the Reich, together with internal debt substituted for foreign claims, is relatively unimportant. The danger arises rather from the fact that, as a result of territorial changes and of the Russian occupation policy in regard to German banks, a large proportion of internal claims against the Reich have been transferred into the hands of foreign governments. The quantitative aspects of this problem are examined in some detail in the following pages.

At the end of the war in Europe the official Reich debt amounted to Rm 400-450 billion and was distributed approximately as follows:

German Reich Debt at V-E Day

(In billions of Rm)

Old foreign debts		1
Institutions administering foreign claims		
Verrechnungskasse	21	
Reichskreditkassen	9	
Banks in Bohemia-Moravia	12	
Nederlandsche Bank	6	
Konversionskasse	1	
		49
Institutions administering German claims		
Reichsbank and monetary institutions	100-120	
Savings system, including postal savings	85- 95	
Credit cooperative system	25- 30	
Insurance institutions	30- 35	
Commercial banks	50- 55	
Mortgage and other special institutions	10- 15	
		300-350
Residual		50
Total		400-450

The greater part of the Reich paper holdings of the Verrechnungskasse and Reichskreditkassen represented counter items against clearing claims of former occupied countries. These claims, together with the Reich debt holdings of the Nederlandsche Bank and the banks in Bohemia-Moravia,[1] were included in the official reparation claims of the respective governments by the Inter-Allied Reparation Agreement. Consequently, the corresponding Reich debt must be regarded as canceled. No decision was made, however, regarding the liabilities of the Verrechnungskasse and the Reichskreditkassen to former German satellites (amounting to Rm 3-4 billion) or to neutral countries (amounting to about Rm 1 billion). At all events, claims of these countries will not be treated better than the comparable claims of former occupied countries and possibly no more than Rm 1 billion of these claims will be recognized.

The old foreign Reich debt and the holdings of new debts in the Konversionskasse which represent old foreign claims--amounting together to about Rm 2 billion--will probably be preserved. Consequently, not more than Rm 3 billion will remain of Rm 50 billion of old foreign Reich debts and of Reich debt holdings of foreign banks and special German institutions administering foreign claims.

In regard to the Reich debt holdings of institutions administering primarily German claims, all debts representing claims of one part of the Reich administration against another can be canceled. These debts amount to Rm 100 to 125 billion and consist principally of holdings of the Reichsbank and of some special institutions, together with holdings of the public administration (included in "Residual" in the preceding table). The remaining Reich debts representing German claims amount to about Rm 250 billion. The expression "German claims," however, refers to claims which were held by institutions inside of the Greater Germany of 1943, while any present adjustment of Reich indebtedness will refer only to the smaller Germany of today, which should have neither obligations to nor claims upon regions taken over by other sovereign powers.

The development of institutions holding Reich debt inside of rump Germany has been strongly affected by the different behavior of the several occupying powers. The following table shows a rough estimate of the direct holdings of the remaining Rm 250 billion of internal Reich debts in the various regions of the former Greater Germany:

Holdings of Reich Debts
(In billions of Rm)

(1) Foreign territories formerly incorporated in Greater Germany[1]	21
(2) Provinces under Polish administration[2]	16
(3) Russian Zone of Occupation	39
(4) Berlin	97
(5) American, British, and French Zones of Occupation	77
Total	250

1/ Excluding the Protectorate Bohemia-Moravia.
2/ Including East Prussia taken over by U.S.S.R.

1/ The Czechoslovak Government, however, made reservations concerning the Giro Account of the National Bank at the Reichsbank.

(1) Foreign territories formerly incorporated in Greater Germany. According to the view adopted by the Inter-Allied Reparation Agreement, the Reich debt holdings of these territories represent counter-items to certain types of occupation costs. Reparation claims for restitution of such occupation expenditures are to be settled in the general reparation agreements. Consequently, the Reich debt holdings of Alsace-Lorraine, Luxembourg, Eupen-Malmedy, Sudetenland, and incorporated Yugoslavian territory of Northern Slovenia must be regarded as canceled. Poland and Austria, however, have not participated in the Inter-Allied Reparation Agreement. Austrian holdings of Reich debt totaling about Rm 7 billion (approximately 2.8 billion dollars) are included in a very questionable Austrian reparation claim of 7 billion dollars concerning which no final decision has been reached. In the reoccupied Polish territories and in Danzig, all credit institutions were "transferred to the State or to Polish legal persons of a public character." The Reich paper holdings of these institutions may be estimated at about Rm 5 billion. Most of these holdings covered deposits made by Germans and later confiscated as German property by the Polish Government.

(2) German provinces under Polish administration. The Reich debt holdings of institutions in the German provinces under Polish administration are of the same origin as Reich debt holdings in the reoccupied Polish territories. Nearly the whole amount of about Rm 16 billion covered deposits made by Germans who have since been expelled and whose properties have been confiscated by the Russian or the Polish occupying power. It is not known whether the Polish Government will regard these confiscated private claims against the Reich (amounting to about Rm 21 billion in both the reoccupied and the newly administered territories) as a Polish claim against Germany. If the Potsdam Declaration is interpreted by the Eastern powers in the same way as by the Western powers, any such claim would be regarded as satisfied by reparations.1/ In the absence of official acceptance of this position by the Polish Government, however, the possibility remains that the holdings may be regarded as a continuing claim against Germany.

(3) The Russian zone and (4) Berlin. The Russian occupying government has taken the position that the Reich debts are valueless paper and that all German credit institutions, since they had invested the greater share of their assets in Reich debt, were to be regarded as bankrupt and closed. Nothing is known, however, about the ultimate fate of the Reich paper and of the other securities which represented the assets of the closed institutions. Probably they were not transferred to the newly opened banks but were in part destroyed and in part taken over by the Russians. The amount of Reich paper holdings was especially great in Berlin since a large part of the central banking activities of the nation was exercised by Berlin institutions. These holdings, excluding Reich paper holdings of the Reichsbank and connected institutions, may be estimated at nearly Rm 100 billion. In addition, about Rm 40 billion were held in the Russian zone. Notwithstanding the fact

1/ According to the Inter-Allied Reparation Agreement, through which the Western nations are implementing the Potsdam Declaration, reparations will be regarded by each of the signatory powers as covering all its governmental and private claims arising out of the war against the former German Government and its agencies.

that the Reich paper has been called "valueless" many times, the claims against the Reich based on Reich debt holdings have not been renounced officially by the Russian administration. Consequently, the Reich debt holdings in the Russian zone and in Berlin must be regarded, at least in part, as a possible future Russian claim against Germany.

(5) The Western Zones of Occupation. Direct holdings of Reich paper in the Western Zones of Occupation may be estimated at Rm 75-80 billion. The value of claims against the credit institutions, however, covered in a direct or indirect way by Reich paper, is much larger, because many banks, especially savings banks, hold large balances in Berlin central institutions which in turn invested in Reich paper.

The present situation relating to the German Reich debt may be summarized as follows:

(a) Old pre-Nazi foreign debts and new internal debts substituted to cover old foreign debts amount to about Rm 2 billion;

(b) Claims of neutral countries and former German satellites covered by internal Reich debts, and Reich debt holdings of Austria and reoccupied Polish territories--amounting together to about Rm 15 billion--have not yet been settled by reparation agreements;

(c) The bulk of the German Reich paper is either a part of the assets of bankrupt and closed German banks (including all important central credit institutions of Berlin) or has been taken over by the Russian or the Polish occupational governments;

(d) Less than 20 per cent (Rm 75-80 billion) of the debts of the Third Reich are actually held by functioning German credit institutions, all situated in the Western Zones of Occupation.

When the Inter-Allied Commission, working in accordance with the Potsdam Declaration, agreed upon German reparations, it was understood that, excluding reparations, the burden of foreign debt upon the new Germany should not exceed a few billion Reichsmarks. In view of the actual distribution of Reich debts, however, and in view of the absence of clear policy statements from Poland and Russia, it is possible that any acknowledgment of these claims might create a large foreign indebtedness which would prejudice the entire reparation program. To avoid the danger of developing an unbearable foreign debt, the following steps should be taken: All foreign claims based on Reich debts and all foreign holdings of Reich debts should be settled by agreement in a manner similar to that in which Reich debt holdings of Western European countries have been handled by the Inter-Allied Reparation Agreement.

In addition, the distribution of the internal Reich debt should be adjusted to the actual political situation in the following way: Reich debt holdings of the closed banks in the Russian zone and in Berlin should be transferred to the new banking institutions together with the liabilities formerly covered by the Reich debts. The holdings of closed central banking institutions should be transferred to existing institutions formerly connected with the closed agencies in amounts corresponding to their claims against the central institutions. After these adjustments, the Reich debt held by German credit institutions, corporations, and private persons inside of the present German territory can be acknowledged but should be reduced. The amount acknowledged for each credit institution should be adjusted to the amount necessary to cover its newly determined and reduced liabilities. These liabilities should be determined and reduced according to social and economic criteria to meet the minimum needs of the creditors. The debt holdings of corporations and private persons should be handled in a corresponding fashion.

An alternative, and perhaps simpler, method for accomplishing the same results would involve cancelation of the entire internal Reich debt and the substitution therefor of new German treasury certificates in all cases where economic or social reasons dictate the partial preservation of the former claims.

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Purchasing Power Parity Calculations for Selected Countries

Florence Jaffy

Before beginning operations, the International Monetary Fund must ask each member country to communicate the par value for its currency, based on exchange rates prevailing on October 27, 1945, sixty days before the Bretton Woods Agreements entered into force. The Fund and each country has at least ninety days, and more time in special cases, after this communication in which to object to the communicated rate as the agreed par value. The Fund will therefore be faced with the problem of making decisions as to suitable exchange rates for each member country. It is important that an appropriate rate be agreed upon at the outset, one which is consistent with eventual relaxation of controls, and which can be maintained over a period of time. Otherwise rate changes will be necessary later on, or exchange controls will become progressively more entrenched as a means of maintaining an artificial rate.

Such decisions call for determination in some way of what rates are likely to be "equilibrium rates" of exchange, however that term may be defined. It is not the purpose here to discuss the definition of equilibrium rates, or to fully describe a method for arriving at them. It is realized that any method, to be valid, must involve numerous steps and must take account of a variety of factors. One such factor, however, is undoubtedly the relative movement of general price or cost levels in the various countries. In a period of severe inflation, carried to varying points in each country, such as the recent war period, it may even be the most important, though decidedly not the only important factor.

The calculation of hypothetical post-war dollar exchange rates by applying to pre-war foreign currency values the ratio of United States to foreign cost or price-level changes may therefore be of interest, if the limitations of the results are kept clearly in mind. If a pre-war period could be selected in which prices and exchange rates could be assumed to be in equilibrium, and if we could abstract from all changes in real economic factors since then, assuming that only a severe monetary change has been operating, then we might expect a rough correspondence between relative changes in price levels and changes in exchange rates among the various countries. As will be pointed out later, these assumptions are unrealistic; accordingly, calculations of the kind to be made here can only yield theoretical rates which reflect relative price movements alone, and cannot yield "equilibrium rates."

It would be most desirable to compare costs of production in the various countries, since costs are more basic to a country's competitive position than prices and would be more relevant to the concept of an equilibrium rate. However, cost comparisons are difficult to make because of the absence of adequate indexes. Wage indexes might be used in their place, but even this information is not available in the desired form for more than a few countries. It has therefore been necessary to fall back on wholesale-price and cost-of-living indexes.

The latter should at least indicate the direction of movement of wages and perhaps even give some idea of the order of magnitude of such movement. Wholesale prices are ordinarily, of course, not good indicators of costs. But in a disturbed period when interferences with international trade weaken the competitive price adjustments of internationally traded goods and when at the same time monetary changes are very large, it may be less objectionable to use wholesale prices as rough indicators of the change in money costs.

Wholesale-price and cost-of-living figures have been collected for as many as possible of the countries belonging to the Fund. The most recent figures available were in some cases no later than September or October of 1945, and in the case of Belgium, July 1945. While an attempt was made to use the same index throughout for each country, this rule had to be abandoned in some instances. For example, in the case of the Netherlands cost-of-living figure, a recent "unofficial estimate" was used in conjunction with the official figures for earlier years. For Belgium, a retail-price index was used for lack of a cost-of-living index. In the Polish data, a recent cost-of-living figure was assumed to have been based on the official index for earlier years as given by the League of Nations. A similar assumption underlies the Greek figures. In the case of France, two indexes were spliced together in order to provide an up-to-date figure. It should also be pointed out that the cost-of-living index for Cuba covers food only; and that for certain other countries, cost-of-living data cover only a single city or a small section of the country. It is probable that most indexes reflect official prices, but the Belgian index is known to include black market prices.

In order to compare price changes in the various countries with those in the United States, all index figures were converted to each of two common base periods. These were selected as being periods of relative stability, when it might be safe to assume that prices and exchange rates in most countries were in the neighborhood of equilibrium. The year 1928 and a nine-month period extending from October 1936 to June 1937 were chosen. The latter period was selected because it preceded the recession of late 1937, and was subsequent to the devaluation cycle of the early 1930's. While use of the later period offers the advantage that the "other variables" which must be abstracted from have less time in which to operate, the earlier base (1928) may have represented a truer equilibrium period. Because of lack of data or incomparability of data, conversions to the selected bases were not always possible. In those cases base periods close to the first choices were used, such as 1929 in place of 1928, or 1937 in place of the nine-month period in 1936 and 1937.

The comparison between price changes in the United States and each foreign country was made on the basis of identical base periods and data for the same recent month. For example, if the base period for a foreign country had to be 1929 instead of 1928, and if the most recent price data referred to January 1946, the United States price index compared with it was a January 1946 figure on a 1929 base. The same principle was followed in applying the ratio of price changes to the base period exchange rate. For instance, in the above example, the ratio of price change in the United States and in the foreign country would be applied to the exchange value of the foreign currency in 1929.

Table I lists, for each country for which data could be obtained, a series of actual exchange rates and a series of calculated rates. Actual rates are given for the periods used as bases for the calculations. Also listed are estimates of the actual rates which will be communicated to the Fund when it begins operations. Finally, a recent rate is given for each country; in most cases this is a May 1946 rate. Actual rates for the months for which the hypothetical rates are calculated (which are generally four to six months earlier than May 1946) were found to differ only slightly from the latest rates and so were not included in the table, except in the Greek case where the earlier rate is given in brackets. At the right of the table are shown the calculated rates, listed according to the base period and type of price index used in their calculation.

Table II lists the 1945 price indexes for each country which were used in calculating the rates given in Table I.

As has already been suggested, there is no reason to believe that either the hypothetical or the actual rates of exchange shown are "equilibrium rates." Therefore the degree of consistency or inconsistency between calculated rates and actual rates cannot be taken as an indication of how close actual rates are to the "equilibrium rate." Nevertheless, it may be instructive to compare the various hypothetical rates with the actual prevailing rates, always remembering that the calculated rates are based entirely on the single factor of relative price movements.

There is a marked tendency for calculated rates to fall below actual current rates. This is especially notable in the cases of Egypt, India, Czechoslovakia, and Belgium. The outstanding exceptions to this tendency are Canada, South Africa, and Uruguay, where all or most of the calculated rates are higher than prevailing rates. Calculated rates also are generally well below actual exchange rates in the base periods, which indicates that inflationary developments abroad have been greater than in the United States.

There is a slight tendency for rates calculated from wholesale price movements to fall below those derived from cost of living movements. This may be explained by the fact that many governments have employed subsidies and other controls to hold cost-of-living prices relatively stable. This tendency is especially noticeable in the United Kingdom data, where both rates calculated from wholesale prices fall below the current rate, while rates calculated on cost-of-living prices are above the actual rate. Other countries showing similar developments are South Africa, the Netherlands, Canada, and Denmark. However, the reverse is true for Czechoslovakia and Mexico.

There is some tendency also for rates calculated from price indexes based on 1928 to fall below those calculated from indexes based on 1936-37. This is noticeable in the data for Belgium, Netherlands, Peru, Uruguay, France, Czechoslovakia, and the United Kingdom. However, there are exceptions, such as Mexico and Brazil; in other cases no consistent pattern appears, the relative position of rates calculated from the same base year depending on whether wholesale or cost-of-living prices were used.

The figures for Norway are striking in that all four calculated rates are very close together and rather close to the prevailing rate. Percentage-wise the South African calculated rates are also near the prevailing rate. The French rate, calculated on the basis of March 1946 wholesale prices on a 1928 base, is very close to the new franc value. The calculated rate for the Greek drachma is much below the rate existing in December 1945, the month for which price figures were used, but is closer to, though still below, the new actual rate. For Poland, the calculated rates fall considerably below the new official zloty rate, but are within the range of open market quotations for the dollar in Warsaw.

Some of the major qualifications which make it impossible to interpret the calculated rates here presented as "equilibrium rates" are listed below.

Changes in real economic forces affecting the balance of payments, such as shifts in reciprocal demands, changes in supply and productivity functions, in investment propensities, and in trade and exchange controls must, of course, be allowed for.

It is unlikely that for every country (if for any) prices and exchange rates were in an exact equilibrium relationship in either base period used. Currencies may have been over- or under-valued in varying degrees.

The permanency of current cost and price levels is highly questionable. This is notably true for countries in the midst of severe inflation, such as Greece, but in all countries there is likely to be some adjustment as price controls are relaxed. Furthermore, the data used here are on the average four or five months old, and many are older.

Even if all real factors remained constant and if base year and current year price levels presented no problems, still no exact correspondence can be set up between the movements of an equilibrium exchange rate and any particular price average, since a monetary change affects not only the general level of any particular group of prices, but the relative position of each individual price, and also the relative position of one sectional price level with respect to others.

To refine the process of estimation of equilibrium exchange rates, it would be necessary to correct for over- or under-valuation in the base year, to allow for expected changes in price levels, and to take account of changes (expected changes) since the base period in real economic factors. It would also be necessary to test results for mutual consistency, since one of the most important goals to be achieved by international action is the attainment of a multilateral pattern of exchange rates.

Table I

Actual and Calculated Exchange Rates for Selected Countries

Country	Actual Exchange Rates (In cents per unit of foreign currency)				Calculated Exchange Rates for Indicated Months: Assuming change since 1928[1] in proportion to relative change in:		Assuming change since 1936-37[1] in proportion to relative change in:	
	1928[1] (Annual average)	Oct. '36-June '37[1] (Average)	Estimated communicated rate[2]	Current rate May 8, '46[1]	Wholesale prices in U.S. and foreign country	Cost of living in U.S. and foreign country	Wholesale prices in U.S. and foreign country	Cost of living in U.S. and foreign country
Belgium	2.79	3.37	2.29	2.28	-	(7/45) .89	-	(7/45) 1.14[3]
Brazil	11.97	6.13	5.18	5.19	-	(9/45) 5.3	-	(9/45) 3.9
Canada	99.91	100.04	90.69	90.71	(12/45) 103.0	(12/45) 106.3	(12/45) 99.3	(12/45) 107.4
Chile	12.15	5.17	3.22	(3/46) 3.23	(12/45) 2.8	(12/45) 3.1	(12/45) 3.1	(12/45) 2.5
Costa Rica	-	16.26[4]	17.79	(1/46) 17.51	-	-	(1/46) 11.2[5]	(1/46) 11.5[5]
Cuba	-	99.92[6]	100.00	100.00	-	-	-	(12/45) 64.5[7]
Czecho-slovakia	2.96	3.51	2.00	2.01	(12/45) 1.4	(2/46) 1.0	(12/45) 1.5	(2/46) 1.3
Denmark	26.74	21.91	20.79	20.88	(1/46) 15.9	(12/45) 17.1	(1/46) 15.4	(12/45) 17.3
Egypt	499.02	503.23	413.13	(3/46) 413.00	(9/45) 225.9	(9/45) 214.2	(9/45) 185.9	(9/45) 221.6
France	3.92	4.59	2.02	.84	(3/46) .82	-	(3/46) .9	-
Greece	1.30	.90	.20	(1/46) .02 [12/45 .20]	-	-	-	(12/45) .012
India	36.47	37.07	30.12	30.18	(12/45) 20.7	-	(12/45) 16.1	(12/45) 20.4
Iran	-	6.07	1.75	(11/45) 1.59	-	-	(10/45) 1.3	-
Mexico	48.18[8]	27.75	20.58	20.58	(2/46) 19.8	-	(2/46) 14.2	(12/45) 12.4
Netherlands	40.22	54.55	37.93	37.79	(2/46) 25.8	(2/46) 29.3[9]	(2/46) 28.5	(2/46) 38.4[9]
Norway	26.69	24.66	20.17	20.20	(2/46) 18.1	(2/46) 18.1	(2/46) 18.0	(2/46) 18.9
Peru	-	25.07[10]	15.38	(12/45) 15.38	-	-	(1/46) 13.9[11]	(1/46) 16.4[11]
Poland	11.21	18.90	[12]	1.00[13]	-	(10/45) .23	-	(10/45) .29
Union of So. Africa	484.20	485.70	400.50	400.50	(11/45) 403.3	(11/45) 413.3	(11/45) 380.3	(11/45) 446.9
United Kingdom	486.62	490.81	403.38	403.34	(2/46) 369.1	(1/46) 421.4	(2/46) 374.5	(1/46) 470.6
Uruguay	102.66	79.47[10]	56.29	56.29	-	(12/45) 62.1[11]	-	(12/45) 69.7[11]

(See following page for footnotes and sources.)

1/ Except as otherwise indicated.

2/ See Review of Foreign Developments for December 3, 1945, for explanation of estimates. Actual communicated rates will be based on those prevailing on October 27, 1945, rather than November 1, 1945, as assumed in Review estimates, but the differences would be slight.

3/ Based on Belgian retail price index, not cost of living. Include black market prices.

4/ 1936 annual average.

5/ 1936 base period.

6/ July-December 1937 average.

7/ July-December 1937 base period.

8/ 1929 annual average.

9/ The month given is only approximate. Figures refer to early part of 1946.

10/ Two-year average, 1936-37.

11/ Two-year base period, 1936-37.

12/ No official rate was in existence. Cross-rates on the ruble rate established for transactions with Russia give 18.87 cents = 1 zloty, but have little meaning. There are reports that the 100 zloty/dollar rate was in use as early as October 10, 1945.

13/ New official rate. Open market rates for dollar in Warsaw in March range from 0.238 to .213 cents = 1 zloty. Earlier quotations range from 0.37 in October to 0.17 in January.

Sources: Price indexes: Given in Table II.
Exchange rates: Federal Reserve Bulletin, Commerce Reports, Foreign Commerce Weekly, and "Communication of Par Values to the Fund," Review of Foreign Developments, December 3, 1945.

Table II

Wholesale Price and Cost-of-Living Indexes

Country		Wholesale Price Index: 1928=100 1/	Wholesale Price Index: Oct.'36-June '37 = 100 1/		Cost-of-Living Index: 1928=100 1/	Cost-of-Living Index: Oct.'36-June '37 = 100 1/
Belgium	-	-	-		328.9 2/	378.3 2/
Brazil	-	-	-	Nov.'45:	239.4	201.5
Canada	Dec.'45:	107.3	125.8	Dec.'45:	99.5	119.6
Chile	Dec.'45:	474.6	210.1	Dec.'45:	415.0	265.8
Costa Rica	Jan.'46:	-	191.6 3/	Jan.'46:	-	185.8 3/
Cuba	-	-	-	Dec.'45:	-	194.4 4/
Czecho-slovakia	Dec.'45:	229.8	298.1	Feb.'46:	321.4	344.2
Denmark	Jan.'46:	185.6	177.5	Dec.'45:	165.6	162.4
Egypt	Sept.'45:	240.8	333.3	Sept.'45:	244.9	289.3
France	Mar.'46:	529.7	646.0	-	-	-
Greece	-	-	-	Dec.'45:	-	9,558.1
India	Dec.'45:	195.1	287.7	Dec.'45:	-	233.0
Iran	Oct.'45:	-	590.9	-	-	-
Mexico	Feb.'46:	273.8 5/	243.6	Dec.'45:	-	284.5 6/
Netherlands	Feb.'46:	172.2	239.3	Dec.'45:	122.9	154.2
Norway	Feb.'46:	162.9	171.3	Feb.'46:	155.8	167.0
Peru	Jan.'46:	235.1	226.0	Jan.'46:	179.8	196.8
Poland	-	-	-	Oct.'45:	5,070.0	8,325.0
Union of So. Africa	Nov.'45:	132.8	159.5	Nov.'45:	123.6	138.9
United Kingdom	Feb.'46:	145.8	163.7	Jan.'46:	122.3	133.9
Uruguay	-	-	-	Dec.'45:	175.1	145.3 6/

1/ Except as otherwise indicated.
2/ Retail price index, includes black market prices.
3/ 1936 = 100.
4/ July-December 1937 = 100. Food prices only.
5/ 1929 = 100.
6/ Average of two-year period 1936-37 = 100.

Sources: Current price indexes: League of Nations, Statistical Bulletin, March 1946, supplemented by consular reports, official publications of certain countries, etc.
Earlier price indexes: League of Nations, Statistical Yearbooks.
Wage data: International Labor Review, plus information supplied by Bureau of Labor Statistics.