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REVIEW OF FOREIGN DEVELOPMENTS

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Calculations Concerning a Commercial Exchange
Rate for the German Mark

Hans J. Dernburg

When Germany was conquered, Allied Military mark currency was introduced by the four Allied powers at rates based on the ratio 1 dollar = 10 Allied Military marks (1 A.M. mark = 10 cents); the new currency was to circulate at par with existing media of exchange. When the new currency was issued, it was stated emphatically that the rate of 10 to 1 was used for military purposes only, and did not represent a new general exchange rate for Germany. Since the German Coinage Law of August 30, 1924, which defines the reichsmark as equal to 1/2,790 kilogram of pure gold, was not repealed by the Allies, it may be argued that there still exists an official German rate of 2.50 marks to the dollar (1 reichsmark = 40 cents), based, as before, on the theoretical gold content of the two currencies.

Whatever the legal situation may be, no rate other than the military rate has been applied. Use of this artificial rate has been possible because international commercial transactions are carried out on a dollar basis with the military authorities exercising a foreign trade monopoly. These authorities, for example, buy wheat in the United States at the American ceiling price and sell it for marks through German intermediaries at German ceiling prices. With proceeds of the wheat sales, the American authorities may buy hops in Bavaria at the German ceiling prices for sale in the United States at the domestic ceiling. As a result, the German dollar-indebtedness resulting from the wheat imports is correspondingly reduced. The illustration shows that American purchase prices and German sales prices (and vice versa) do not need to be

interrelated in this kind of transaction. While, theoretically speaking, individual or global exchange rates could be computed from such transactions, they are by no means necessary for the trade. Determining factors are the German import demand (which must be met for political and humanitarian reasons) and the desire on the American side to lower the total outlay in dollars through sale of German exports. In individual cases, direct barter deals in terms of dollars have been concluded. For example, potash and salt will be exported from the United States zone to Czechoslovakia to the value of 407,000 dollars, while coal and coke valued at 113,000 dollars will be imported from that country. Payment for these imports will be made from proceeds of the potash and salt exports, leaving a dollar balance in favor of the United States zone. As can be seen from this illustration, transactions with countries other than the United States are also transacted in dollars. The furnishing of transportation facilities within the United States zone, e.g., for the Paris-Prague-Vienna train service, is now regarded as a German export and the countries operating trains passing through the United States zone must therefore pay the charges to American authorities in dollars.

However, the use of the dollar as a unit of account does not seem to have fully obviated the need for an exchange rate for commercial purposes. There are transactions--and with greater normalization of conditions these transactions will increase--which can not be carried out on an equitable basis until a commercial exchange rate has been established. This is especially true in connection with the appraisal in dollars of services rendered to foreigners in Germany and for the conversion into marks of German dollar claims arising from transactions not related to the occupation. Due to the complexity of rail tariff charges, it is wholly impracticable to attempt evaluation of such services on a United States dollar basis and, as a result, foreign shippers or consignees have so far not been billed for rail transit freight charges. The dollar value of such services, on the other hand, could be easily ascertained if a commercial exchange rate for the mark had been established. Foreign air lines, now beginning to operate in Germany and having no mark balances available, want to convert dollars into marks in order to meet current expenses for local goods and services. Foreign correspondents and news agencies in Germany are in need of mark funds for their current expenditures. Foreign ships in German ports for repair are unable to defray their expenses for want of German marks. Benevolent remittances from abroad to Germany can not be admitted in the absence of an appropriate exchange rate. Discharged prisoners of war, having received military payment orders and certificates of credit, cannot receive the proper equivalent in marks upon return to Germany as long as no exchange rate, other than the military rate, has been established. In some transactions of these types, final settlement has simply been postponed (as in the case of freight charges and in meeting the claims of former prisoners of war), a situation which causes insecurity or uncertainty for debtor or creditor. In other exceptional cases (such as that of foreign correspondents or of the air lines), the rate of 10 marks to the dollar has been used, in the absence of any other rate, although the transaction involved may not have been for the benefit of military operations or military occupation.

It would be unwarranted to introduce or to continue for all these transactions the military rate of 10 cents to the mark, which greatly undervalues the mark. The internal purchasing power of the mark, based on maximum legal prices and wages, is invariably in excess of 10 cents. Sale of the mark at the military exchange rate, if permitted on a large scale, might have serious inflationary effects within Germany. Moreover, foreign nationals dealing with Germany would profit unduly from such an exchange rate. If, for example, the 10-cent rate were conceded to foreign nationals shipping goods through Germany in transit, they would strike an undeserved bargain in view of the low legal prices for such services in Germany. More importantly, the total amount of dollars received from the transaction would be disproportionately small. The latter is a rather serious **objection** under present circumstances. The Allies are finding the occupation of Germany an expensive undertaking. Aside from the direct costs of troop maintenance, which are charged to reparation account, there are large expenditures for German imports, especially food, which cannot be met from the proceeds of current exports. At the end of February, exports and export commitments from the United States zone covered only 9 per cent of the estimated import commitments; this ratio had, however, by early April increased to 32 per cent, principally as the result of a large order for the export of lumber from the zone to the United Kingdom (14.3 million dollars). There is, of course, considerable interest in arriving at more favorable ratios between exports and imports, and in eventually balancing the accounts. Establishment of an exchange rate higher than the 10-cent military rate which could be charged to foreign shippers, airlines, news agencies, etc., would raise the foreign exchange proceeds and allow the tapping of new exchange resources such as emigrant remittances.

Before the war, the mark was worth 40 cents officially, but exports agreed that it was considerably overvalued. It was symptomatic that Germany subsidized her exports and that blocked mark exchange sold at considerable discounts. That the degree of overvaluation was probably about 30 per cent was indicated by the fact that Aski-marks, on which basis Germany traded especially with the Latin American countries, were traded at such a discount. Moreover, when Germany annexed Austria and the Sudetenland, the rate of exchange between the local currencies and the mark was so fixed as to depreciate the mark by some 30 per cent below its official value. The object was probably to fix a rate of exchange with the newly absorbed territories at or near the equilibrium level in order to minimize price level adjustments. Assuming a 30 per cent overvaluation, the mark was actually worth only about 28 cents before the war.

As a result of increased war-time incomes at relatively low levels of consumption, purchasing power accumulated during the war; very rigid price controls, however, mitigated the effect on prices of the steadily growing inflationary potential. While under Germany's system of "stable inflation" prices rose rather moderately, prices in other countries, some of them under German occupation, seem to have risen very much faster. The result was that the mark, which at the beginning of the war had been overvalued, was now undervalued to

varying degrees with respect to other currencies. After the conquest of Germany, the occupying powers maintained German price and wage ceilings while in other countries political and economic pressures were partly successful in breaking wage and price ceilings established during the war. Thus the pre-war price structure of Germany has been virtually preserved (always leaving black markets out of consideration), while the price structures of other countries have risen to a considerable degree and, in many instances, are still rising.

With the German collapse, black markets have sprung up all over the country. In these markets goods are traded at prices often several hundred times as high as the legal ceilings. These prices, however, have no relation to wages. An ordinary factory worker makes 50 marks a week and can buy a rationed loaf of bread for .75 mark. If he were to buy the same loaf of bread on the black market, it would cost him 100 marks. It is obvious that his current income does not allow him to buy on the black market. He could increase his diet through black market purchases only if he were himself selling personal property in the black market or were using up his savings from the war period; the latter would be quickly exhausted. Since black markets are small and the wage structure is based on legal prices for rationed goods, black market prices have been ignored in the following calculations of a purchasing power rate for the mark. The countries chosen for comparison of price developments in Germany and abroad have been countries in which price controls have been relatively effective and black markets relatively small.

It is a truism that when an exchange rate with the dollar is set, exchange rates with respect to the pound sterling, the Swiss franc, etc., are established simultaneously. This results from the fact that fixed relationships between the dollar and the other currencies already exist. These rates do not necessarily reflect the relative price levels of the countries concerned. They may be maintained at artificial levels because both trade and exchange transactions are subject to many restrictions. These discrepancies pose a rather difficult problem in connection with establishment of a new rate for the mark. One may establish, for example, a rate for the mark which represents a close approximation to a purchasing power parity rate with respect to the dollar, while by the same act undervaluing the mark with respect to other currencies.

The following table gives the development of cost-of-living indexes and of wholesale price indexes in Germany and in seven other countries which can be considered rather stable economically and politically and which have not devalued their currencies in recent years. For want of these conditions in individual cases, the table omits some countries which before the war were important to Germany's trade, such as France, Poland, and certain countries in southeastern Europe. The countries included, however, accounted for about one-third of German trade in 1938.

Cost-of-Living and Wholesale Price Indexes in Early 1946
(January-June 1939 = 100)

	<u>Cost-of-living indexes</u>	<u>Wholesale price indexes</u>
United States	131	140
United Kingdom	132	176
Netherlands	170	214
Denmark	158	186
Norway	158	171
Sweden	143	169
Switzerland	151	201
Average	149	184
Germany	112	111
Average as percentage of German indexes	133	166

In comparison with the pre-war period, the cost-of-living index rose on the average by 49 per cent in the seven countries listed, and the wholesale price index by 84 per cent. The rise in Germany was only 12 and 11 per cent, respectively. Accordingly, the average cost-of-living index for these countries rose by one-third more and the wholesale price index by two-thirds more than in Germany. Taking a mark rate of 28 cents as the approximate pre-war equilibrium rate, one can compute a purchasing power rate of 37 cents to the mark, when the computation is based on the cost-of-living index, and of 46 cents to the mark when it is based on the probably less conclusive wholesale price index.

A different approach to the problem is to compare directly present food prices in Germany with those in other countries. The cost of the monthly ration for the average German family consisting of two adults and two children is 41.73 marks, while the cost of the same basket in the United States at present has been computed at 22.61 dollars. This would give a ratio of 54 cents to the mark.

The computed rates are thus 37 cents (cost-of-living index numbers), 46 cents (wholesale price index numbers), and 54 cents (direct comparison of food prices between Germany and the United States). On the basis of these calculations, one would not go very far wrong in seeking an appropriate rate somewhere between 40 and 50 cents.

There are considerations which would suggest selecting for the time being a rate somewhat above a calculated purchasing power parity, whatever the latter may be. There has been a marked tendency for countries selecting exchange rates for the post-war period to revert to pre-war parities or to give their currencies a comparatively high value as against the dollar, paying scant attention to the true relative purchasing power of their money. Because of this trend the European currencies seem to be comparatively little out of balance as among

themselves, while overvaluation with respect to the dollar is considerable.^{1/} If under these conditions a European country were to establish a dollar rate near the parity level for its currency, that country would obviously be placed at a disadvantage with respect to its European trading partners. Calculations show, for example, that in the case of Czechoslovakia the exchange rate against the dollar has been established between 24 and 100 per cent above the calculated parity rate. If, on the other hand, the new mark-dollar rate were established at a purchasing power parity level, the terms of trade between Germany and Czechoslovakia would be much to the disadvantage of Germany. To avoid undervaluation of the mark as against the Koruna, one would have to overvalue the mark as against the dollar.

There may be strong political and psychological objections to giving the mark a value higher than 40 cents, which was the pre-war rate and, to be sure, a very much debated one. The considerations discussed above, however, should be a warning to those who may want to establish the mark rate at, say, 25 or 30 cents under the calculated purchasing power parity level. They should realize that the mark will already be undervalued with respect to other European currencies, even if it is established at a purchasing power parity level.

To what extent an exchange rate adapted to present conditions will prove adequate in the long run will depend, of course, on price and wage developments in Germany and abroad. The Germans seem to anticipate a monetary reform. Small currency and Allied Military marks are hoarded and Allied Military marks are exchanged against other German currency at a premium, in the (possibly quite unwarranted) expectation that small currency and Military marks will be exempted or less affected by possible deflationary measures. By clearing away sufficient pent-up purchasing power, a currency reform may establish equilibrium between the money supply and the national output at the present level of legal prices. There are, however, a series of structural changes, dislocations, and bottlenecks which will tend to force prices upward. These influences will be more apparent when the paper flood has been cleared away. A rough guess may place the price rise at 20 per cent above the present level of legal prices. Substantial price rises, however, are also likely to occur in other countries where pressure toward an upward revision of prices can be more easily exercised than in a country under military occupation. Such price rises are likely to neutralize to a considerable degree the effect which a one-sided price rise in Germany would otherwise have on the German exchange rate.

1/ See Review of Foreign Developments, May 20, 1946, and June 3, 1946.

Budgetary Problems of the Independent Philippines

John Extor

With the achievement of independence by the Philippines on the Fourth of July, Manuel Roxas, the newly-inaugurated President, will face a strange financial paradox. His government will have unprecedentedly large dollar balances and can look forward confidently to several years of surpluses in the international balance of payments, but may nevertheless be driven to seek American loans to cover large internal budget deficits.

The explanation of the paradox lies very largely in the inflexibilities of the Philippine gold-exchange standard monetary system, the fundamentals of which were prescribed as long ago as 1903 by the late Professor Kemmerer acting in his first role as "money doctor." The currency consists principally of Treasury certificates which, like our silver certificates, were originally intended to be backed 100 per cent by silver deposited in the Treasury Certificate Fund in the Philippine Treasury. In practice, the 100 per cent reserve requirement has been met almost entirely by dollar deposits in the United States Treasury or in member banks of the Federal Reserve System. Metallic currency is also backed to at least 15 per cent of the total in circulation by United States dollars held in the Exchange Standard Fund.^{1/} The Philippines must by law maintain free convertibility between the peso and the dollar at the official rate of 1 peso = 50 cents, and must not restrict capital movements to the United States. These restrictions will continue after independence, if the Philippines accept the terms of the Philippine Trade Act recently passed by the United States Congress. Nor is the inflexibility of the monetary system eased by the banking system. There is no central bank, and such bank notes as have been issued by other banks in the past are outstanding in small amounts and have either become a liability of the Treasury or are rapidly being redeemed. There is only slight possibility of expansion of bank deposits by the commercial banks. The bulk of the population uses currency in preference to deposits and the banks customarily hold very high cash reserves (in the range of 30-60 per cent).

As a result the monetary circulation immediately reflects surpluses and deficits in the balance of payments, no matter what their cause.

The budgetary problem of the Philippine Government stems from the more basic economic problem of restoring the national income after the devastation of war. The Philippines have been called "the most devastated land in the world." Manila probably suffered as much destruction as any other of the world's largest cities. Some of the smaller cities in the Islands, such as Cebu and Zamboanga, suffered even more. The American War Damage Corporation has estimated losses in the Islands at about 800 million dollars based on 1935 values, which would be well over 1 billion dollars in current values. This figure

^{1/} Until November 1945 Treasury Certificates were also backed by a 15 per cent minimum reserve in the Exchange Standard Fund. Since those certificates also had a 100 per cent reserve in the Treasury Certificate Fund, their total reserves were 115 per cent.

does not include shipping losses, variously estimated at 20 to 70 million dollars. President Roxas has estimated total war damage at 1 billion dollars in pre-war values or 1.5 billion dollars in replacement cost. The United States has assumed partial responsibility for reconstruction of the Islands. Congress has passed the Rehabilitation Act authorizing the appropriation of 525 million dollars to be paid to private and governmental claimants and the transfer of 100 million dollars of surplus property to the Commonwealth Government. Nevertheless, the productive capacity of the Islands has been so reduced that national income in real terms cannot be expected to recover to pre-war levels for several years.

Although General MacArthur, upon reoccupying the Islands, declared all currency issued under Japanese auspices to be worthless, there was subsequently a considerable expansion of the official currency. The pre-war Treasury certificates, most of which had gone into hoards, were supplemented by a new issue of certificates called "Victory pesos." Their circulation increased rapidly as the American armed forces increased their expenditures. By September 1945 the total currency issue was approximately 1 billion pesos as compared with 222 million pesos in September 1941. Since then the circulation has gradually decreased; by April 30 it stood at 815 million pesos. It should be noted, however, that the volume of currency actually in the hands of the public is considerably less than this, chiefly because of the sizable peso holdings of the American authorities. On April 30 such holdings may have been as much as one-fifth of the total circulation.

During reoccupation of the Islands, American expenditures contributed to a rapid rise in prices. A turning point was reached during the summer of 1945, however, as imports from the United States began to arrive in larger quantities. The downward trend of prices since that time has resulted chiefly from a continued flow of American imports which has tended to reduce prices in two ways: by increasing the supply of goods in the market, and by decreasing the currency in circulation by exactly the amount of pesos paid for imports. With United States Government expenditures during the past year running at a lower level than formerly, their inflationary effects have not been enough to offset the deflationary effects of imports. As a result, by the end of April 1946 the cost of living in Manila was down to about 3.5 times pre-war as compared with about 8.5 times pre-war in the middle of 1945. The present level is still roughly 2-1/2 times as high as the cost of living in the United States.

It is difficult to predict the course of prices in the immediate future. Imports during the first three months of 1946 were at the rate of approximately 30 million dollars a month, or more than twice the 1938-40 average rate. These might be expected to decrease as the stocks of goods in the Islands are built up and as the surplus of currency is diminished. Before the end of the year, however, heavy expenditures are anticipated for Army construction projects in the Islands, for redemption of legitimate guerilla currencies, and for meeting arrearages of pay to the Army of the Philippines which was incorporated into the American Army in July of 1941. The arrearages, particularly, are expected to run into sizable sums, and payments against these obligations may more than offset the amounts spent on imports. In this case, the present trend toward lower prices might well be arrested or reversed.

Before the war the Philippine Government had for years operated with balanced budgets. It is true that in the few years immediately preceding the war small deficits had occurred, but these were easily covered by surpluses accumulated in the general fund in previous years. While balancing the budget the Philippines have also had low taxes. For this there were two principal reasons: first, the American Government in a variety of ways assumed functions which the Filipinos themselves will have to assume when they become independent; and second, many items of capital expenditure appeared in an "extraordinary" budget the revenue for which was derived from remittances by the United States of the proceeds of excise taxes collected on the processing of coconut oil from Philippine copra. These remittances will cease when the Islands become independent.

Since the reoccupation of the Islands by American troops, the budget has been very seriously out of balance. Of the principal pre-war sources of revenue, which included excise taxes, a sales tax, import duties, and income taxes, only the sales and excise taxes have produced much revenue. Customs receipts have been negligible because virtually all imports have come from the United States and are by law duty-free. Income tax receipts have been low because the national income is low and probably also because the tax is not easy to collect. The national income will not revive until reconstruction of the country is well under way. Even the sales and excise taxes have yielded much less than they might have if the internal revenue administration had not suffered from disorganization and inadequate rates of pay.

While revenues have been much lower than before the war, expenditures have been much higher. The Government has unusual expenses, particularly for rehabilitation and national defense, which it never had before. Government salary scales have increased because of the higher cost of living. As a result the deficit has been large and promises to continue so for some time. For the fiscal year 1946, revenues from taxation were only 21.5 million dollars, while total expenditures and obligations were 163 million, of which 28.7 million represented funds appropriated but not spent. For fiscal 1947, total revenues are estimated at 28 million dollars and total expenditures at 127 million.

Thus far the Government has been able to meet its expenses without borrowing by drawing upon the general fund, the strain on which has been eased by payments from the United States to the Philippine Treasury of nearly 68 million dollars, which represents all but 5 million dollars (still to be remitted) of the balance of coconut oil and sugar excise taxes collected by the United States Treasury on Philippine products shipped to the United States. In addition, the Philippine Treasury benefitted from release of reserves from the Exchange Standard Fund when President Truman signed a bill in November 1945 removing the 15 per cent reserve requirement from all Philippine currency except metallic coins. In spite of these windfalls, the Government has only enough remaining in the General Fund to cover expenditures of the next few weeks.

While the internal problems of war devastation, inflation, and government deficits are discouraging, the international position of the Islands is more favorable. With imports now running at the rate of 350 million dollars a year, the official gold and dollar assets stood at 464 million dollars on May 6; of this sum 431 million were currency reserves. In addition, there are private long-term assets, estimated at 14 million dollars, and an unknown amount of private short-term assets, perhaps as much as 50 to 100 million dollars, in the United States.

The balance of payments during the next few years promises to be favorable in spite of a low level of exports. The principal receipts are expected to be the very large United States Army and Navy expenditures in the Islands during the years 1946 and 1947, after which time the rate of payments under the Rehabilitation Act^{1/} will probably be running at a high level. Since the total payments authorized by the Act are 520 million dollars (in addition to 100 million worth of surplus), their favorable effects on the balance of payments will be tremendous.

Thus the plight of the Philippine Government has most unusual aspects. Because of the 100 per cent reserve requirement, neither can it use its dollar balances for imports on government account, nor can it meet its budget deficit by expanding the note issue. Moreover, the heavy United States Government expenditures in the Islands will be primarily to private persons rather than to the Philippine Government. Such payments as are made to the Government under the Rehabilitation Act for the restoration of destroyed public properties must be made after the Government has already met the expenses of restoration from its own funds. The immediate effects of the Act, therefore, are to accentuate the already critical shortage of free Government funds.

No matter what other measures the Philippine Government may take to meet its deficit (over 100 million dollars for fiscal 1947), it must in any case make every effort to increase tax revenues. Since the Filipinos have never been heavily taxed, there is room for increases in rates to bring the level of taxation to that of most other countries. The problem is that sharp increases in rates would encounter popular resistance, particularly at a time when incomes are low. Increases in excise and sales taxes, already the most important revenue producers, appear to offer the most fruitful possibilities for increasing revenues quickly. By extending excise taxes to cover additional commodities, particularly imports, and by raising the rates, it is probable that the return from them might readily be raised to 25 million dollars, twice the pre-war level. The sales tax, which is now 3-1/2 per cent on most articles, 5 per cent on semi-luxuries, and 10 per cent on luxuries, could also be raised and made to bear most heavily on luxuries and semi-luxuries. In addition to raising revenues, such increases in excise and sales taxes would have the effect of reducing imports of consumer goods, particularly luxury items, on which the Filipinos are now tending to dissipate their holdings of cash.

^{1/} For a detailed discussion of the provisions of the Act, see Review of Foreign Developments, April 22, 1946.

The possibilities of internal borrowing are limited. The national debt is very small, so that there is no developed bond market. Moreover, rates of return on alternative investments in the Islands are high, so that the interest rate on a government bond issue would have to be prohibitively high. In order to borrow at low rates, the Government might develop some scheme of compulsory lending, or possibly a lottery loan. Nor are the possibilities of borrowing from the Philippine National Bank very great without revision of existing legislation regarding P.N.B. reserve requirements and the size of its note issue, and a change in the Bank's practice of not issuing notes.

The Government will be able to raise some funds through the sale of vested enemy properties, the value of which has been estimated at 40 million dollars at pre-war prices, and through the sale of United States surplus property, 100 million worth of which at fair value is to be turned over to the Philippine Government under the terms of the Rehabilitation Act. Unfortunately, neither category of sales is likely to yield pesos in the immediate future.

When the Islands become independent, the Legislature, if it wishes to do so, can lower the reserve requirements, thus making it possible for the Treasury to increase the peso issue and to use some of the freed dollars for essential imports on Government account. If a limit were placed on the Treasury's power to issue notes and if the business community were assured of the maintenance of free convertibility of the peso (perhaps by establishment of a stabilization fund), such a solution of the Treasury's problem would be entirely feasible. An alternative expedient might be to authorize the Treasury to have a fiduciary note issue of 100 or even 200 million pesos, meanwhile retaining the 100 per cent reserve requirement against Treasury certificates.

We must conclude, then, that without changes in existing legislation the Philippine Government will be forced to borrow in the United States to cover its internal budget deficits. Possibilities of borrowing will probably be limited to a loan from the Export-Import Bank, primarily to cover reconstruction expenditures, or a direct United States Treasury loan requiring specific Congressional action. Because of the many uncertainties in the financial future of the Philippine Government, the chances of floating a bond issue in the New York market appear slim.

In any case, the predicament in which the Philippine Government finds itself is not of its own making. The currency system, in particular, has been prescribed by the United States. In addition, many obligations, such as those to maintain the peso at 50 cents, to maintain free convertibility with the dollar, to place no restrictions on capital movements, and to permit American goods to enter the Islands duty-free, have been legislated by the American Congress. To the extent that these restrictions hamper the Philippine Government in its efforts to solve its internal problems, they increase the American Government's responsibility for the satisfactory solution of those problems. We have prescribed the rules and the pattern of the economic development of the Philippines for the coming decades; we should not shirk our responsibility to relieve some of the hardships which those rules entail.

Prospective "World Bank" Securities

Lewis N. Dembitz

With the selection of Mr. Eugene Meyer as President of the International Bank for Reconstruction and Development, it is expected that staffing and organization of the Bank will proceed rapidly during the summer and that actual lending operations may begin by September. June 30 has been mentioned as a possible date for the Bank formally to "commence operations;" in this case, payment by member countries of the first 2 per cent on their capital subscriptions would become due within sixty days or by the end of August. Hence, by September 1, the Bank could have a fund of 153 million dollars (in gold and United States dollars) with which to begin operations. Additional calls for capital will be made, probably until the Directors have called up the full 20 per cent of each country's subscription as permitted by the Articles of Agreement. In addition, it is expected that by the fourth quarter of 1946 the Bank will make an initial offering of its securities to the American investing public.

Ability to market a large volume of securities at reasonable rates is essential to achievement of the Bank's objectives. The resources of the Bank, including the amounts callable if needed from member governments on their **unpaid** capital subscriptions, will be large in relation to the Bank's liabilities. For this reason, it may be expected that the Bank's obligations will be considered as entitled to a good investment rating. Assuming this to be the case, a strong demand for the securities can be anticipated.

In considering the prospective investment quality of these securities, it is helpful to examine the relationship that will exist between the Bank's resources and its liabilities. To illustrate this relationship, a hypothetical (pro forma) balance sheet can be drawn up. The balance sheet given below is intended to illustrate the possible relationship between the Bank's assets and liabilities at a time (necessarily several years hence) when its outstanding loans have reached the limit permitted by the Bank's Articles of Agreement. This hypothetical balance sheet is based on the following assumptions:

1. The membership of the Bank consists of those countries which are members on June 1, 1946, with total capital subscriptions of 7,670 million dollars.
2. The Bank will have called in the full 20 per cent of its subscribed capital, or 1,534 million dollars. It will have used 1,000 million dollars of these funds (including all gold and United States dollars paid in by members) for making loans, leaving 534 million dollars in foreign currencies in the Bank's treasury.
3. The Bank will not yet have accumulated any surplus or reserves, so that its loan limitation is 7,670 million dollars. This entire amount is assumed to be outstanding. These loans, except for the 1,000 million dollars available from the Bank's paid-in capital, are financed by the sale of 6,670 million dollars of debentures.

Hypothetical Balance Sheet for the World Bank
(In millions of U.S. dollars)

Loans outstanding	7,670	Debentures	6,670
Foreign currencies in treasury	534	Capital subscribed	
Due from member countries on capital subscriptions, subject to call to meet Bank's liabilities:		Paid-in	1,534
From U.S.A.	2,540	Subject to call to meet Bank's liabilities:	
From others	3,596	By U.S.A.	2,540
	<u>14,340</u>	By others	<u>3,596</u>
			<u>14,340</u>

Ratios (based on the above assumptions): The 2,540 million dollars due from the United States would provide a 38 per cent coverage when applied against the 6,670 million dollars of debentures outstanding. As to the remaining 4,130 million of debenture liability not so covered, the Bank would have claims on foreign countries amounting to 7,670 million dollars plus 534 million plus 3,596 million, or a total of 11,800 million dollars, equal to 2.86 times this liability. Thus, if only a little over one-third of the claims on foreign countries proved collectible, this would still produce the 4,130 million dollars needed to provide for full payment of the debentures. In practice, the ability of the foreign countries to make their respective payments will be further enhanced by the fact that these payments cannot fall due in a single lump sum, but will fall due gradually over an extended period of years.

If the Bank's loans outstanding were increased above 7,670 million dollars (on the basis of additional countries joining the Bank and thereby increasing its subscribed capital above that figure), then the ratios of coverage calculated above would be reduced. On the other hand, the ratios will be improved as the Bank accumulates reserves out of interest and commissions received from borrowers. They will also be improved if the Bank retains any part of its lending power unused.

The foregoing balance sheet and ratios assume that the Bank will operate by borrowing funds and relending them, rather than by guaranteeing loans issued by others. However, if some of the Bank's operations were to take the form of guaranteeing loans issued by others, this would not change the ratios calculated above. Some part of the "Loans outstanding" on the debit side would be replaced by "Liabilities of borrowers on guaranteed obligations," and some part of "Debentures" on the credit side would be replaced by "Liability of Bank on guaranteed obligations;" there would be no change in the totals nor in the resulting ratios.

United States-French Economic and Financial Agreements

M. A. Kriz
Federal Reserve Bank of New York

On May 28 France received United States credits totaling 1.4 billion dollars. Together with the 550 million dollar Export-Import Bank loan granted last September, France has obtained almost 2 billion dollars from the United States. This figure represents about one-half of the aggregate foreign lending of the United States since the end of hostilities, excluding the 3.7 billion dollar loan to the United Kingdom awaiting ratification by Congress, while the two Export-Import Bank loans to France--550 million dollars in September 1945 and 650 million last month--amount to one-third of the Bank's lending power. The magnitude of the United States aid raises, therefore, the following questions: (I) What is Franco's program of reconstruction and modernization which "will facilitate the integration of Europe in the world economy and enable France to resume her place as a great producing and trading nation;"^{1/} and (II) what stake has the United States in its implementation?

I. THE FRENCH RECONSTRUCTION PROGRAM

"The French Government has made known to the United States Government its plan for the reconstruction and modernization of the French economy...The two governments have examined this plan and have agreed that the attainment of its objectives should make possible full participation by France in cooperative achievement of an expanding world economy."

Present State of French Economy. From the documents submitted by the French, three main facts emerge clearly: Even before the war, French capital equipment was obsolete; this situation was greatly aggravated by the war; and in spite of substantial results achieved since liberation, French industrial production remains very low.

How obsolete the French industrial plant was even before the war is shown by the following facts: In 1938 the average age of French machine tools was approximately 25 years, as against 7 to 9 years in England and 5 to 7 years in the United States. In comparison with 1900, man-hour productivity by 1938 had increased 330 per cent in the United States, but only 130 per cent in France. Labor output in French industry before the war averaged about one quarter of that in the United States; in agriculture a single producer in France fed only five consumers, whereas in the United States he fed fifteen. Taking the economy as a whole, labor output in the United States was three times greater than in France.

^{1/} All quotations in this study are from the statements jointly released by the Government of the United States and by the Provisional Government of the French Republic on May 28.

Six years of war, including four years of occupation, with the accompanying physical destruction, German capital levies, the exhaustion of stocks and deferred maintenance, inflicted on France a total loss of capital estimated by the French at 28 billion dollars. Because of domestic disinvestment of such magnitude, France's economic position today is profoundly different from that of other countries. The United States met its war requirements through a great increase in production; Great Britain suffered a loss of financial capital but preserved her industrial plant; French production, however, fell to one-half of the 1938 level, or to less than two-fifths of the 1929 level; and despite the fact that French consumption had been reduced by one-half at the end of occupation, France was left without the means for maintaining, even at the inadequate pre-war level of replacement, the buildings and machinery which had escaped destruction and looting.

In spite of the substantial progress which has been made since liberation (for example, the restoration of communications and the expansion of domestic coal output to more than the 1938 level--an achievement unparalleled in any other country), French industry today is producing at only about 60 per cent of its 1938 rate. At this level, production is clearly too low to sustain even a moderate level of consumption and leave an adequate margin for investment. The conclusion is obvious: To ensure economic recovery, French production must be increased substantially.

Modernization and Re-equipment Program. A higher level of industrial production would allow a rate of investment high enough to replace war losses of capital and to renew obsolete equipment. As a first step, therefore, the French plan to increase production by the end of 1946 to as high a level as is possible within the existing overall plant capacity. As a second step, they intend to expand their present economic potential to a level that will allow an increase in industrial production by perhaps as much as 25 per cent over the all-time industrial peak attained in 1929.

The French plan to raise their industrial production by the end of 1946 to the level of 1938, by 1947 to 10-15 per cent above 1938, and by 1950 to some 50 per cent above 1938. These goals may seem very high. As a matter of fact, however, 1938 was a year of mediocre industrial activity, and the basis of comparison is therefore unduly low. The reasonableness of the French objectives is shown in the following table:

Production Goals

	<u>Basis</u>	<u>Actual</u>	<u>Goals</u>	
		<u>April-May</u> <u>1946</u>	<u>1947</u>	<u>1950</u>
Industrial Index	(1929=100 (1938=100)	57 74	88 115	118 153
Agricultural Index	1938=100	75	85	105

The French lay great emphasis on an increase in production of coal and hydroelectric power. By 1950 coal production is planned to exceed the 1938 level by 40 per cent and the 1929 level by 22 per cent, while electric power production is to continue the pre-war growth at an accelerated rate, exceeding in 1950 the 1938 level by 100 per cent and the 1929 level by 180 per cent. Another striking feature of the French program is the projected creation of a machine tool industry. While France had a mechanical and electrical equipment industry before the war, the present objective is to broaden and modernize this industry in order to enter world markets and to provide the French economy with most of the equipment required for reconstruction and modernization. The French objective for this industry is a 1950 output 50 per cent above 1938, but only 7 per cent above 1929. On the whole, consumption goods industries are scheduled to increase much less than producers' goods industries. Moreover, a part of the increase in consumption goods output over the 1938 level will go to reconstituting depleted household and trade stocks and to rebuilding exports. This disparity between the high goals set for producers' goods industries and the more moderate objectives for consumption goods reflects the French desire to speed reconstruction by means of their own resources, even at the cost of retarding improvement in the standard of living.

Investment Plans. With the above production objectives in mind, the French Government has directed the development of an over-all plan for the general modernization and re-equipment of the economy. The plan is in course of preparation by what is known as the Council of the Plan, which is headed by the President of the French Government and is composed of members of the government, chief industrialists, trade union leaders, and administrative officials. The Council provides the directives which are interpreted and coordinated by the General Commissariat of the Plan, headed by M. Jean Monnet. They are to be translated into practical strategy by a number of modernization committees, one for each basic industry, in which are represented the best available industrial brains of the country, whether employer or employee.

The investment program calls for a total investment of 12 billion dollars in the six years 1945-1950, of which 2.4 billion dollars are to be imported. This total includes firm investment programs for coal mining, electric power, fuel, railroads, the merchant marine, and the steel industry, representing together about 40 per cent of the total. Individual programs for other industries are still partly tentative.

The largest proposed investment is for modernization and improvement of transport. Railroads and ocean shipping will be affected primarily, with railroad investment accounting for approximately one-half of total transport investments. In order to meet the traffic requirements inherent in the general economic objectives, which in 1950 would exceed 1938 traffic by 25 per cent, the greatly depleted rolling stock will have to be doubled. The entire railroad investment program is to be met by domestic production after 1946. The investment program for the merchant marine contemplates a restoration of the pre-war tonnage by 1950.

The power investment program is a second large item in the total. In view of France's need for importing coal and the expected continuance of a tight coal supply situation in Europe, the French plan to expand domestic coal production from 50 million tons annually to 65 million appears reasonable. As a corollary of the industrial and agricultural program, electric power production is to be doubled by 1950 as compared with 1938, involving an expansion of existing hydroelectric facilities by about 80 per cent.

A third key factor in the entire program is the modernization and moderate expansion of the steel industry. The production of steel is to increase by 1950 about 25 per cent over 1929.

The French expect eventually to rely on domestic production of mechanical and electrical equipment and machine tools. In order to speed their expansion, these industries will require large imports of capital equipment.

Investment in residential housing will be confined to construction of temporary housing, to urgent repair and reconstruction of existing dwellings, and to construction of a sufficient number of new dwellings to house the increased industrial labor force. Only an insignificant part of the investment in housing is to be met directly from imports.

In the textile industry, the French contemplate for 1950 only a 5 per cent expansion over the 1929 output, but they are preparing an extensive modernization program which in five years would replace one-third of the installed textile machinery and permit a substantial reduction in textile labor requirements.

Supply of Labor. To ensure a supply of labor adequate for attaining the production objectives, the French contemplate an increase in the industrial labor force from its present level of 5.4 million (excluding 250,000 war prisoners) to 8 million in 1950. In 1938 the industrial labor force, including the unemployed, was 6.1 million. To achieve this objective, several hundred thousand persons who left the industrial labor force during the occupation are to return; an even larger number of agricultural workers will have to seek industrial employment; a third large portion of the needed labor will be drawn from the groups which are at present classified in the categories of trade, professions, banking, and government services, and from the army. Moreover, industrial workers will have to immigrate from abroad. In order to release agricultural workers, the French plan to introduce into French agriculture 200,000 tractors and other agricultural machinery, and otherwise to increase agricultural productivity. Large-scale transfer of persons from trade, professions, services, government services, and the army appears possible in view of the abnormal increase in the first three categories during the occupation and the planned reduction in the size of the army during 1946. Employment of immigrant labor has long been a feature of the French economy. A vigorous recruitment policy and provision for the necessary housing and other facilities will, however, be required if the 1950 goal is to be reached.

The French manpower program presupposes full cooperation of French labor. The labor situation has been favorable in recent months. In spite of rapidly rising prices and lagging wages, there have been virtually no strikes, and labor unions have agreed to accept an incentive wage system and a 48-hour basic work week, compared with the pre-war average of 38.7 hours. However, the demand for a general wage increase of 25 per cent, which the Communist-controlled General Confederation of Labor made before the recent elections, may prove an ominous sign indicating a change in the attitude of labor toward reconstruction plans.

Conditions for Realization. The attainment of the French production goals depends primarily, in the short run, on coal; in the long run, on the feasibility of the investment program.

A fundamental assumption of the whole plan is that France will be able to obtain the necessary supply of coal. In spite of the increase in domestic coal output to a level higher than in 1938, France is unable fully to utilize her available production plant and manpower because of the inadequacy of the coal supply on the basis of present imports. During the decade from 1929 to 1938, coal imports averaged 28 million tons a year, or 2,300,000 tons monthly, of which 800,000 tons came from the United Kingdom, 900,000 from Germany, and 540,000 from Belgium and the Netherlands. The present level of coal imports is at a rate of only 10 million tons a year, or 800,000 tons a month, of which 100,000 tons are coming from the United Kingdom, 470,000 from the United States, and 330,000 from Germany. No increase in coal imports from the United Kingdom can be expected because English production is only about three-fourths of the pre-war output. Because of the cost of United States coal (20 dollars a ton at French ports, or more than twice the price of European coal), its import is too burdensome an item in the French balance of payments to be long continued. Moreover, because of the recent coal strike, French imports from this country have been interrupted. Under these conditions, French requirements can be met only by additional imports from Germany. For this reason the French have lately been emphasizing the absolute necessity for France to receive each month from Germany at least 1 million tons more of coal. The sentence in the United States-French joint statement to the effect that "the United States Government will continue to assist France in securing an adequate supply of coal from Germany" suggests definite action in this direction.

In the long run, the successful implementation of the French reconstruction plan depends on the feasibility of the investment program. Indeed, the most pertinent question raised by the program is whether the French economy will be able to sustain the required rate of capital formation. Over the four-year period 1946-1949, according to the French program, 18 per cent of the net national income plus imports is to be absorbed by investments, including necessary inventory accumulation to restore stocks to a working level. This is a very high proportion indeed, leaving only 82 per cent available for consumption. If this rate of investment can be accomplished, the program calls for French national income to increase from 82 per cent of 1938 in 1946 to 132 per cent in

1949, which would be approximately the 1929 level. Because of the high rate of investment during this period, and despite the magnitude of net imports, consumption would rise more slowly from 88 per cent of 1938 in 1946 to 115 per cent in 1949. Consumption would then, however, still be only 90 per cent of the 1929 level. These figures indicate that the present level of consumption would be increased during the period 1946-1949, although, because of less adequate housing and the depletion of consumers' stocks, the 1938 standard of living would probably not be reached until 1949.

The maintenance of such a high rate of investment is not something to be taken for granted. It implies that severe controls be maintained over the French economy, restricting consumption at the same time that spendable income will be increasing. The traditionally high French propensity to save may prove, however, a source of strength in implementing the program. Should consumption not be adequately restricted through voluntary saving, rationing, and administrative controls, inflationary pressures will inevitably tend to reduce consumption through their effect on wages and fixed income. Should the French economy follow such a course, the high rate of investment required by the reconstruction program could probably still be maintained, but the price which the French would have to pay for their inability to maintain adequate controls would be great social and economic dislocations. More particularly, a sustained increase in the French price levels would have an unfavorable effect on French exports and hence would aggravate the French balance-of-payments deficit.

The French Balance-of-Payments Deficit. French economic policy as outlined above cannot be implemented without a large and comprehensive import program. Because of this and because of the small volume of exports in the initial reconstruction period, the French balance of payments will show a heavy deficit over the next four years. The magnitude of the deficit^{1/} may be illustrated by the following quotation from a statement made by the President of the French Provisional Government on May 29:

"We shall have to face in the next four years a possible deficit estimated...at 6,150 million dollars. Three billions, which is nearly one-half, will be covered by our private and public resources in gold and foreign currency, our gold production and foreign credits obtained prior to the agreement /United States-French agreement of May 28/ ... There will therefore be a balance of about 3,150 million dollars.

"Part of this, estimated at approximately 940 million dollars ... may be expected to be covered by German reparations and credits from countries other than the United States ... There still remains a balance of approximately 2,200 million dollars."

^{1/} Since the French Government has not released for publication its estimates of the balance of payments for the initial years of the reconstruction period, no detailed comments on this portion of the French program can be circulated at this time.

II. UNITED STATES FINANCIAL AID TO FRANCE

United States Loans to France. In order to cover the residual balance-of-payments deficit in the near future, the French have obtained American financial assistance "pending the time when the International Bank for Reconstruction and Development will be in full operation." The American financial aid includes: (a) a direct loan of 650 million dollars from the Export-Import Bank; (b) a line of credit totaling 720 million dollars for the purchase of United States surplus property now in France and in French overseas territories, and for the payment of goods supplied to France by the United States Government since the end of the war; and (c) additional credits for the purchase of American-owned merchant shipping.

The contract covering the 650 million dollar Export-Import Bank loan has not yet been signed at this writing. The interest rate is stated to be 3 per cent and the term 25 years; however, no repayments of principal are to be effected during the first five years, the entire amortization of capital being made in the remaining 20 years. The first Export-Import Bank loan to France granted in September 1945 carries interest at 2-3/8 per cent and is repayable in 30 years, beginning July 1, 1946; these are the same terms as those of the lend-lease "3(c)" agreements.

The 720 million dollar line of credit for the payment of goods supplied to France since the end of the war and for the purchase of United States surplus property located in France and in French overseas territories carries interest at a rate of 2 per cent per annum, beginning July 1, 1946. Beginning on July 1, 1951, interest and principal will be paid in thirty equal annual installments.^{1/} Should the payment of any installment not be "in the joint interest of both governments," "because of extraordinary and adverse economic conditions arising during the course of payments," payments may be postponed for a period agreed upon by the two governments.

In comparing the terms of the United States-French agreement with the earlier "3(c)" agreement of February 28, 1945, the following differences are worth pointing out. The interest rate is 2 per cent, instead of 2-3/8 per cent as under the "3(c)" agreement; the repayment of principal, which was to have started immediately under the "3(c)" agreement, is postponed by five years in the new agreement; and while the "3(c)" agreement called for the repayment of principal by equal annual installments, the new agreement provides for repayment of principal and interest by equal annual installments, so that the average maturity of the loan is longer under this new schedule. Moreover, the text of the joint statement regarding the conditions of postponement of payments in case of balance-of-payments difficulties may be interpreted as covering not only principal amortization, as was apparently true in the "3(c)" agreement, but also interest. However,

^{1/} Part of these payments will consist of 15 million dollars worth of real estate and 10 million dollars worth of francs which the United States will use to buy and improve real estate or to carry out "educational programs agreed between the two governments."

there is no waiver of interest along the lines provided for in the Anglo-American loan agreement, but only conditional postponement; and the clause providing for postponement lacks a precise definition, such as that contained in the Anglo-American loan agreement, of the conditions under which it would operate.

Of the 720 million dollars, 300 million dollars are destined for the purchase of American war surplus in France and in French overseas territories. France is to acquire these stocks at about 20 per cent of their cost price. The remaining 420 million dollars represents a net sum in payment for goods supplied to France since the end of the war. Many complex adjustments were made prior to determination of this figure which is still subject to revision pending the final agreement on the accounting procedures. It includes the so-called "3(c)" credits extended to France under the agreement of February 28, 1945, and therefore does not represent a completely new credit to France. Only to the extent that the settlement wiped out certain French obligations which had previously been payable on a cash basis, and in part transferred them into a straight lend-lease category and funded the balance, was real relief granted to the French balance of payments.

Discussions are taking place for an additional credit, subject to the provisions of the Merchant Ship Sales Act of 1946, whereby France will acquire approximately 750,000 tons of merchant shipping owned by the Government of the United States.^{1/} Newspaper reports estimate such credits as amounting to "at least" 25 million dollars. By purchasing these ships, France will effect substantial economies on her ocean freight.

Final Settlement of Lend-Lease. Apart from the loans, France has drawn various benefits from the financial and economic agreements concluded on May 28. The United States and the French Government have reached an understanding for the final settlement of lend-lease and reciprocal aid, of the French obligation to the United States Government under the military supply program (Plan A), and of other financial claims of each government against the other arising out of the war.

Military and civilian lend-lease obligations arising prior to September 1, 1945, have been cancelled. The United States has renounced all claims for the repayment of 2-1/4 billion dollars worth of military stores and equipment supplied to France during the war and against which France supplied only 870 million dollars in reciprocal aid. Furthermore, the United States has also renounced its claims for the payment of amounts outstanding for deliveries made to the French and North African civilian populations. These claims total 300-400 million dollars. This settlement is, however, subject to the following qualifications: (1) the French Government is to extend "appropriate non-discriminatory treatment" to United States nationals in the use and disposition of installations in the building of which there has been a United States Government contribution and which are transferred under this settlement;

^{1/} The two countries have already agreed that France should receive 17.5 million dollars for loss or damage to French vessels or cargoes while under our control. This includes the settlement for the luxury liner Normandie which burned in New York harbor.

(2) the United States Government reserves its right of recapture, while indicating, however, "that it does not intend to exercise generally this right" (with certain specific exceptions); (3) the disposal for military use to forces other than French armed forces of lend-lease articles held on September 2, 1945, or received thereafter by the French armed forces and the disposal for civilian use other than in France or in French overseas territories of such lend-lease articles will be made only with the consent of the United States Government, and any net proceeds will be paid to the United States Government. The French Government will not, except to a very limited extent, release for civilian use in, or for export from, France and the French overseas territories lend-lease articles held by the French armed forces.

Agreement on Commercial Policy. The two governments found themselves

"in full agreement on the general principles which they desire to see established to achieve the liberation and expansion of international trade which they deem to be essential for the realization of worldwide prosperity and lasting peace."

Moreover, by extending credits to France and by assisting France in securing an adequate supply of coal from Germany, the United States is to help the French to reconstruct and modernize their economy so as to

"facilitate the integration of Europe in the world economy and enable France to resume her place as a great producing and trading nation."

Before the war, France, with her overseas territories, had an important and stable share in world production and trade. From 1913, just before the First World War, until 1938, France's share of world production varied between 5-1/2 and 6 per cent, a proportion not widely divergent from her share in world population--5.2 per cent. Before the Second World War, France was the fourth largest exporting and importing nation, being surpassed only by the United States, the United Kingdom, and Germany.

The United States-French agreement has, therefore, far-reaching commercial-policy implications. From the very inception of the recent loan negotiations, the French pointed out that the degree to which France will be able to contribute to a world of expanding production and trade in conformity with the objectives of the international economic policy of the United States will depend primarily upon the opportunities that are given to her to undertake and achieve the reconstruction and modernization of her agricultural and industrial economy. In the absence of such aid as will enable her to procure the raw materials and equipment required to start her industries going full speed and to re-establish equilibrium in her balance of payments, France will have to slow down the pace of reconstruction and modernization, maintain and strengthen the existing economic controls, earmark her available gold and foreign assets for the purchase of capital goods, and rule out foreign trade, except through bilateral trade arrangements. That such a course would be detrimental to other trading nations, and more particularly to the United States, is beyond doubt.

As a result of the United States-French negotiations, the two governments, reaffirming "complete agreement at all important points" on the principles expressed in the Proposals for Consideration by an International Conference on Trade and Employment, agreed to work together for reciprocal tariff reductions in advance of the forthcoming World Trade Conference.

"The two governments are of the opinion that the prior conclusion of agreements among the major trading nations of the world for the substantial reduction of tariffs and other barriers to trade and for the removal of discriminatory arrangements would contribute greatly to the success of the World Conference."

A similar provision, it should be noted, was contained in the joint United States-British statement regarding the understanding reached on commercial policy, issued on December 6, 1945, at the close of the Anglo-American loan negotiations.

The French Government has advised the United States Government of the following specific moves: (a) a new French tariff is being prepared which will contain ad valorem duties only and which will not increase the degree of protection over the level which existed prior to the war. This new tariff will serve as the level from which reciprocal reductions will be negotiated in the forthcoming multilateral conference. (b) France has definitely abandoned her pre-war policy of protecting French producers with import quotas. (c) The French Government has reiterated that it has abandoned the price equalization (percequation) procedure, "which it was compelled to use provisionally during the period prior to the revaluation of the franc in order to facilitate exports."

However, the abolition of quantitative restrictions has been qualified by the French Government to the extent that the latter

"must maintain import controls within the framework of an import program, but that it will maintain such controls only so long as they are necessary to safeguard the equilibrium of its balance of payments and to achieve in an orderly way its plan of reconstruction and modernization."

It was also formally stipulated that the French Government would administer the issuance of import licenses under the French import program

"without discrimination as among foreign sources of supply as soon as France possesses, or is able to earn, sufficient free foreign exchange so that it is no longer necessary for her to make purchases within the limits of bilateral trade and financial agreements."

The avoidance of discrimination in the application of such quantitative trade restrictions as are to remain during the transitional period is a principle defined in considerable detail in the Proposals for Expansion of World Trade and Employment.

The two governments have also reached agreement on the return to private channels of trade between France and the United States.^{1/}

On the other hand, various measures^{2/} were discussed in the course of the negotiations with a view to promoting French exports to the United States, inasmuch as

"the two governments have agreed that important benefits would accrue to both countries from a substantial expansion of French exports to the United States."

Brief reference may also be made to two other **agreements** reached by the two governments. First, each government is to license freely and without royalty to the nationals of the other, under conditions of reciprocity, all former German-owned patents which have come into the full possession of either government (with certain qualifications); and second, the French Government will accord to American nationals who have suffered damage to their properties in France, through causes originating in the war, compensation equal to that payable to French nationals having the same types and extent of losses. Such equality of treatment is accorded to French nationals with reference to war damages to property in the United States.

Finally, the two governments have agreed to begin negotiations as soon as possible looking toward the conclusion of "a modern and comprehensive treaty of establishment, commerce, and navigation."

1/ The French Government has already restored to private channels a large part of the import trade of France and its overseas territories. Temporarily, however, a part of French imports will be handled by associations of private traders until the difficulties of loading, shipment, and transport of essential supplies and their distribution in France are overcome. French Government procurement in the United States will be limited to equipment for public corporations and agencies. For the time being, government procurement will also be continued for a restricted list of items, such as short-supply foodstuffs, steel, lumber, tires, and certain medical supplies.

2/ The two governments have discussed "certain United States laws and regulations which, in the opinion of the French Government, tend to hamper unduly the importation of French products into the United States. Special attention has been given to trade mark and copyright legislation, the use of geographical names related to particular products, price control of imported goods, and valuation of imported goods for the assessment of customs duties. The various agencies of the United States Government which are concerned with these matters have agreed to give careful and sympathetic consideration to the views of the French Government and study the possibility of altering their administrative procedures or recommending to Congress the revision of existing legislation."

On the whole, the joint declaration on commercial policy reiterates the general principles formulated in the Proposals issued by the Department of State at the close of the Anglo-American loan negotiations. Likewise, the stipulation providing for conclusion of agreements "for the substantial reduction of tariffs and other barriers to trade and for the removal of discriminatory arrangements" prior to the World Trade Conference restates similar proposals in the Anglo-American joint statement. However, while the Anglo-American loan agreement, aimed, in its commercial policy implications, primarily at eliminating exchange restrictions and ensuring convertibility of sterling balances in general, the specific provisions of the United States-French agreement concern essentially an elaboration of a new French tariff (and subsequent negotiations of reciprocal tariff reductions), elimination of the French policy of quantitative trade restrictions, and prevention of direct or indirect export subsidies. These differences between the two sets of agreements reflect, of course, the differing problems and policies that had to be dealt with.

Conclusions

I. The production goals of the French economic program appear reasonable in terms of France's actual achievements in the 'thirties and also in terms of the long-term expansion of national income of the United States and the United Kingdom. However, the attainment of the French economic objectives will depend upon the ability and willingness of the French Government and people to devote a large proportion of their current income to investment, to maintain and accept the necessary controls over production, consumption, and finance, and to achieve the full cooperation of private management and labor. If it is successfully implemented, the reconstruction program will enable France to balance both her domestic economy and her international accounts.

II. The French are fully aware that the re-equipment and modernization of their agricultural and industrial economy depend primarily on their own resources and energies. However, without the impetus provided by the addition of imported resources, the development of production in France would proceed at too slow a rate; France would be unable for a long time to restore her economic balance; and she would not be able to participate in the common efforts to liberate and expand world trade. Hence the French, while resolutely using their available official and private gold and assets abroad, have been anxious to obtain credits from the United States and other countries.

III. The United States has extended to France financial aid of a magnitude of 2 billion dollars. The agreement is part of the broad program, inaugurated by the Anglo-American agreement, for reviving international trade among the three largest exporting and importing nations in the world. The American financial aid to France is, therefore, to be looked upon as an integral part of the international economic policy of the United States.