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REVIEW OF FOREIGN DEVELOPMENTS

April 8, 1947

This review is intended primarily for internal circulation, and should in no case be cited or quoted. It consists of personal and informal contributions by the authors, which in many cases represent very tentative analyses of the subjects considered.

Note

Mr. Charles R. Harley, who has been editor of the Review for the past two years, has relinquished this work in order to devote his full time to other assignments. Mr. Harley deserves most of the credit for the improvements in the standards and usefulness of the publication which have taken place during his period of editorship. His outstanding critical faculties and ready spirit of cooperation have been greatly appreciated by the contributors. We are fortunate in having Miss Cornelia B. Rose resume the work of editorial direction.

J. Burke Knapp

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Some Comments on Mr. Hoover's Report on German Industry — J. Herbert Furth

Mr. Hoover's third report deals with the restoration of German industry and includes programs for the long run and for the "interregnum before peace". It assumes six goals of American policy: the establishment of a unified nation within the present borders of the four zones of occupation; the elimination of Nazis from German public life; complete permanent disarmament; effective international guarantees of denazification and demilitarization; reconstruction of Germany into a peace-loving nation; and conclusion of a peace treaty that "contributes to the restoration of productivity and lasting peace in Europe and promptly relieves us of drains upon our taxpayers". The report deplores the attempts to transform Germany into a "pastoral state", the restrictions of the "level-of-industry" plan, and the Russian and French reparation policies. It brands five ideas as illusory: that the reduction of

Germany to a "pastoral state" could be accomplished without exterminating or removing 25 million Germans; that heavy industry would represent a "war potential" even if Germany remained disarmed; that German light industries could be expanded sufficiently to produce the exports needed to cover German import requirements; that Germany could become self-sufficient under the "level-of-industry" plan within the present German boundaries; and that Europe could recover without the economic recovery of Germany.

The report proposes a long-run program of four points: (1) free German industry from all restrictions, save for a control commission to prevent rearmament; (2) end the removal and destruction of any non-arms plant throughout Germany; (3) return the enterprises seized by Russia to German ownership and management; and (4) leave the Ruhr and Rhine districts an integral part of the German economy, save for a control commission to allocate coal exports during the period of general coal scarcity. Apparently the report assumes that no reparations will be paid out of current output. For the "interregnum" period, in view of the violations of the Potsdam Agreement by Russia and France, the report proposes to apply the long-run program in the merged American-British zones, and especially to abandon the limitations of the "level-of-industry" plan and to develop all industries, heavy and light alike, that can produce non-arms goods.

The proposals certainly would be beneficial, from the purely economic point of view, to both Germany and the rest of the world, including the American and British taxpayers. Two questions, however, remain: first, whether unrestricted heavy industry does not, after all, represent a dangerous "war potential" even in case of complete permanent disarmament; and second, whether the imposition of restrictions upon heavy industry would actually have economic consequences as disastrous as those feared by the report. The first problem cannot be answered by economic arguments; it should be pointed out, however, that the most complete and permanent disarmament of Germany would not prevent it from becoming an arsenal for other aggressive nations. As to the second problem, the position of the report may be summarized under three headings: (1) German food import requirements are so high that very large industrial exports are indispensable; (2) exports of light industrial products cannot be expanded so as to replace exports of heavy industrial products; and (3) restrictions upon German heavy industries would ruin the rest of Europe. The following discussion will consider these points exclusively in their long-run aspects.

German Import Requirements

The report overestimates the burden of foodstuff imports for post-war Germany by assuming that an average diet of 2,600 calories daily per head of the population would require annual imports of $1,250 million. The report states that before the war Germany produced 85 per cent of its consumption of around 3,000 calories and that the loss of the territory east of the Oder-Neisse line reduces domestic supplies by 25 per cent. This means that under normal conditions the remaining territory produces around 64 per cent of 3,000 calories, or 1,920 calories daily per head of the population of the pre-war Reich. The population of the post-war territory will be approximately the same as that of the pre-war Reich since the war losses will be about balanced by the natural increase during the intervening period and the inflow of "expellees" from Eastern Europe. On the basis of the assumptions made by the report, the deficit to be covered by imports will thus be around 680 calories daily per head, or 17,374 billion calories per year for a population of approximately 70 million. This deficit can be covered by the importation of around 4.2 million metric tons of breadgrains, 0.4 million tons of fats, and 1.6 million tons of feedgrains (for meat and milk production), costing at present prices about $820 million.1/

Table I
German Post-war Food Import Requirements

Item	Quantity (millions of metric tons)	Calories Per gram	Calories Total (trillions)	Cost a/ Per ton	Cost a/ Total (millions of dollars)
Breadgrains	4.0	3	12.0	106	424
Fats	.4	9	3.6	660	264
Feedgrains	2.4	3/4	1.8	55	132
Total	6.8	-	17.4	-	820

a/ Based on mean of highest and lowest prices in New York during first quarter of 1947 for wheat, lard, and oats.

Since the present abnormal level of agricultural prices is bound to decline in the near future, the cost after 1947 probably will not be higher than $700 million. The amount thus would be smaller by $430-550 million than the estimate made by the report.

The report does not give any estimate of other necessary imports. On the basis of the figures for Germany's foreign trade in 1936, adjusted for the reduction in raw material requirements for heavy industries due to the restrictions of the "level-of-industry" plan and for the decrease in the importation of consumers' goods due to the standard-of-living formula of the Potsdam Agreement, current non-food imports may be estimated as follows (at present prices averaging 150 per cent of pre-war): textile raw materials (around two-thirds of 1936 volume, on account of increased rayon production) $400 million; raw materials for other light industries (full 1936 volume) $360 million; raw materials for heavy industries (around 40 per cent of 1936 volume) $240 million; consumers' goods, including coffee and tobacco (around half of 1936 volume) $170 million. Non-food import requirements thus would be around $1,170 million,2/ and total import requirements would be around $1,870 or 1,990 million, depending upon the price level of foodstuffs.

1/ The amount would be only slightly larger than the foodstuff requirements of the merged U.S.-U.K. zones as the Russian zone is nearly self-sufficient in food (see this Review, January 28, 1947, supplement). The estimates in this paper differ from those presented previously in that they are based upon a daily consumption of 2,600 calories (following Mr. Hoover's report) rather than of 2,800 calories, and that the importation of feedgrains has been increased slightly at the expense of breadgrains. Moreover, price changes in the first quarter of 1947 were taken into consideration.

2/ For a more detailed explanation of import estimates, see this Review, op.cit. The estimates in the present paper differ from those presented previously in that requirements of light industries are increased from 75 to 100 per cent of pre-war, and imports of finished goods from 20 to 50 per cent. As a result, the sum of non-food imports is larger by around 30 per cent than their value as envisaged in the "level-of-industry" plan.

German Export Capacity

The report overestimates the need for, and underestimates the possibilities of, an expansion of light industrial exports required to cover necessary imports. It is true that in 1936 exports of heavy industrial goods accounted for 60 per cent of total German exports while exports of mining products were about 10 per cent, and light industrial goods around 30 per cent of the total. It does not follow from these figures, however, that light industry would need an expansion in total output and therefore larger capital investment than before the war in order to furnish the exports necessary to offset the restrictions upon heavy industry.

The limitations imposed on heavy industry by the "level-of-industry" plan do not preclude all exports of heavy industrial products.1/ If we assume for the sake of argument, however, that exports of heavy industrial products would stop completely, the volume of light industrial exports would have to be approximately 180 per cent of pre-war in order to cover import requirements. Such a goal would not be unrealistic, and, in fact, would be very similar to the export program of British industry. It would not imply an expansion of production, but merely a reduction of domestic consumption to a level that in most cases would be higher than that envisaged by the "level-of-industry" plan (75 per cent of 1936). In those cases where such an increase in exports would force a greater reduction in domestic consumption (metal goods, optical products, and textiles), exports would be limited so as to leave domestic consumption at 75 per cent of pre-war. Applying this method to the principal light industries, which furnished more than 90 per cent of all German light industrial exports in 1936, we find that exports of those industries would expand to around $1,410 million.

Table II
Principal German Light Industrial Exports, 1936 and Post-war

	1936		Post-war Capacity a/	
	Millions of reichsmarks	Per cent of output	Millions of dollars	Per cent of output
Metal goods and optical industries	366	32.1	336	49.1
Glass, stone, and ceramics industries	163	9.5	176	17.1
Wood, paper, and printing industries	229	9.2	248	16.6
Textiles	453	16.0	492	28.8
Clothing and leather industries	147	10.5	158	18.9
Total	1,358		1,410	

a/ Volume: 180 per cent of pre-war, or reducing domestic consumption by 25 per cent, whichever is smaller. Price: 150 per cent of pre-war.
Source of 1936 figures: "Die Deutsche Industrie", Berlin, 1939, pp.44-55 and 90.

1/ In 1932, when German steel production was slightly lower than the volume permitted under the "level-of-industry" plan, German exports of heavy industrial products were about as large as in 1936.

Exports of mining products, despite the loss of the Upper Silesian coal fields, could be increased by around 20 per cent as the result of the diminished demand of heavy industries. They would yield about $490 million at present coal prices ($10 per metric ton), or $330 million if coal prices recede again to a level comparable to that of industrial products.1/ Miscellaneous other exports, excluding heavy industrial products, would add around $130 million. The total would thus reach $1,870-2,030 million, depending upon the level of coal prices; this would be sufficient to cover the estimated imports of $1,870-1,990 million.

These calculations obviously are extremely rough, but they may suffice to indicate that it would not be altogether impossible to equilibrate Germany's balance of current international payments on the basis of the Potsdam declaration and the "level-of-industry" plan, provided, however, that no reparations are being paid out of current output and that the cost of imports necessary for reconstructing destroyed light industries are defrayed out of foreign credits.

Impact upon other Countries

The report objects to an expansion of German light industrial exports on the ground that such exports would compete with those of the rest of the world. This is obviously true, but not more so than of heavy industrial exports which the report wants to foster. On the contrary, it is not impossible that heavy industrial plants of countries other than Germany, e.g., Russia, the United States, Czechoslovakia, and Austria, have expanded during the war to such an extent that a revival of German heavy industry would actually create a problem of excess capacity. Moreover, the demand for heavy capital goods would be greatest during the period of transition, before the rehabilitation of German production could be completed, and may fall off heavily in later years. On the other hand, the expected industrialization of undeveloped countries (Middle and Far East and Latin America) may, in the long run, increase international demand for light industrial goods requiring particular skills, such as Germany has to offer (precision instruments, optical goods, glass, ceramics), and this increase may prove more permanent than the rise in demand for heavy capital goods.

It is true that the program would mean a reduction of the volume of German foreign trade to around 70 per cent of 1936, or around 45 per cent of 1929. Some reduction would take place in any case, however, as the necessary consequence of the impoverishment of Germany by war and occupation. Moreover, if it is true, as has often been asserted, that the expansion of German heavy industry was due at least in part to unfair trade practices and government subsidies, the removal of such practices and subsidies automatically would bring about a further decrease in heavy industrial exports and thus probably in the entire volume of German foreign trade.

The report finally overestimates the importance of the restrictions imposed by the "level-of-industry" plan upon the economy of the rest of Europe by stating that they would "keep Europe in rags". There is grave danger that the agricultural nations of Eastern Europe, which depended most heavily upon the German market in pre-war days, would be compelled in any case to adjust themselves to the Russian economy and to sever part of their commercial relations with Germany. Other countries, e.g., France, Belgium, and Czechoslovakia,

1/ Estimates of coal exports are explained in this Review, op.cit., p. 9. The present estimate of mining products takes into consideration the potash production of the Eastern zone of occupation.

appear to feel that they would profit rather than lose from the limitations upon German heavy industry. The Scandinavian countries may be able to compensate their losses by intensifying commercial relations with the United Kingdom and Russia. Austria in any case would be prevented for political reasons from reviving its pre-war economic ties with Germany. Only the Netherlands is bound to suffer heavy net losses from the impoverishment of Germany, but even in that case the readjustment needed on account of the changes in relations with the East Indies may bring about a reorganization of the country's economic system that could soften the impact of developments in Central Europe.

Conclusion

These comments do not detract from the soundness of the proposals of the report on the subjects of plant destruction and removal, return of Soviet-controlled enterprises to German management, and integration of the Ruhr and Rhine area into the German economy. Moreover, they should not convey the impression that the Potsdam declaration and the "level-of-industry" plan form an ideal or even an adequate solution of the German economic problem. Many provisions of these agreements appear to go beyond the limits that can be justified on political or military grounds (e.g., restrictions upon fertilizer production) or to impose hardships on other countries that are out of proportion to possible advantages which the occupying powers might derive (e.g., the suspension of shipments of spare parts). Furthermore, the regimentation made necessary by the enforcement of countless artificial limitations is contrary to the fundamental political and economic tenets of the United States and detrimental to the re-education of the German people in the spirit of Western democracy.

For these reasons, despite the criticism to which some of the estimates and arguments have been subjected, the report may well point in the right direction.

British Settlements Regarding Sterling Balances in Western Europe

Frank M. Tamagna

On February 26, 1947, the British Government signed three Supplementary Agreements, amending the Anglo-Belgian Monetary Agreement of October 5, 1944, the Anglo-Netherlands Monetary Agreement of September 7, 1945, and the Anglo-Portuguese Monetary Agreement of April 16, 1946. In the preamble to each Supplementary Agreement, it is stated to be the desire of the British Government "to extend the scope of the arrangements resulting from the ... 'principal Agreement' with the view to facilitate trade and payments and the avoidance of unnecessary restrictions".

Specific reference in the Agreements was made to the obligations assumed by the British Government under the International Monetary Fund Agreement. Although no mention has been made as to conformity of these Supplementary Agreements with the obligations undertaken by the British Government under the Anglo-American Financial Agreement, an examination of their terms reveals that they do in fact conform with its provisions.

In order to assure that transfers made under the terms of these Agreements will be limited to current transactions only, facilities for automatic transfers are applied exclusively to particular non-resident accounts or classes of accounts "which the monetary authority or exchange control in the country concerned is prepared to supervise" in such manner as to prevent their use for capital transactions, and the Bank of England designates as "Transferable". These accounts maintain their national identity by bearing, in addition to the word "Transferable", the denomination of the country of which the account holder is regarded as resident, e.g., Belgian, Netherlands, and Portuguese Transferable Accounts. (The Argentine and the Canadian Accounts have also been re-designated as "Transferable".) The Bank of England has designated as "Transferable" the account of the National Bank of Belgium, the account of the Netherlands Bank and 63 other Netherlands accounts, and six accounts of the Bank of Portugal and 41 other Portuguese accounts.

Under these Supplementary Agreements, all sterling balances (whether from past or current accumulation) of the European countries to which the "Transferable Account System" has been extended (Belgium, Netherlands, and Portugal) are made freely available by the British Government "for making payments for current transactions [or of a current nature] to residents of countries outside" the particular (Belgian, Netherlands, or Portuguese) monetary area.

The British Government agrees also that the Bank of England will purchase (a) from the National Bank of Belgium and the Netherlands Bank "any sterling which [these banks] may hold" under the conditions laid down in Article VIII, Section 4(a) of the Articles of Agreement of the International Monetary Fund; namely

(i) that the balances to be bought have been recently acquired as a result of current transactions; or

(ii) that their conversion is needed for making payments for current transactions;

and (b) from the Bank of Portugal "any sterling which ... may have accumulated in respect of payments of a current nature under the terms of [the] Agreement [of 1945] provided that the conversion is required for making payments of a current nature".

The Bank of England agrees to redeem such sterling balances in the national currency of the creditor country (in francs, guilders, and escudos), or in gold, at its option. Conversely, the Bank of England retains the right (stipulated in the "Principal Agreement") to sell francs, guilders, and escudos against all or part of the sterling balances held by the National Bank of Belgium, the Netherlands Bank, and the Bank of Portugal.

These provisions seem to indicate that the Bank of England, under the terms of the Articles of Agreement of the International Monetary Fund--referred to in the Belgian and the Netherlands Supplementary Agreements--undertakes to convert not only sterling currently acquired but also past accumulated Belgian and Netherlands sterling balances, if needed for current transactions with other monetary areas; whereas under the terms of the Anglo-Portuguese

Supplementary Agreement it undertakes to convert only such portions of Portuguese sterling balances accumulated from current transactions as may be required for current payments in other monetary areas. In other words, in the cases of Belgium and Netherlands all sterling balances apparently are being made available for current transactions, whereas in the case of Portugal, a non-member of the Fund, certain limitations are being maintained.

The working arrangements of the Supplementary Agreements may be described as follows:

(a) Transferable Accounts may be credited with balances with other sterling accounts in the same country or monetary area which are not designated as Transferable Accounts; the British are not concerned with these transfers which do not affect the total volume of sterling balances. In practice, the shift of sterling from private to official account would facilitate the enforcement by monetary authorities of controls over the use of the balances.

(b) Balances from Transferable Accounts may be credited to American Accounts for payments in current transactions, subject to supervision by the monetary authority of the country concerned, and to reporting by the paying bank to the Bank of England.

The Bank of England stands ready to convert into dollars, sterling from Transferable Accounts upon being received into an American Account, but not sterling from a Transferable Account directly. This technical limitation is significant because of certain important practical aspects. So long as the sterling rate in the New York market exceeds or remains equal to the official buying rate for sterling (4.02-3/4), the amount of Transferable sterling which will be converted into dollars through American Accounts will not exceed such volume as the New York market will absorb at any time at that rate. In other words, the Federal Reserve Bank of New York (acting on behalf of the Bank of England) will only be offered additional sterling (against dollars) if the market rate declines below the official buying rate.

The existing arrangements, whereby sterling accounts may be freely transferred for current as well as capital payments within the sterling area, are unaffected by these Supplementary Agreements--Transferable Accounts remain freely available for capital transactions within the sterling area but cannot be used in capital transactions with other (such as the dollar) monetary areas. Similarly, blocked sterling accounts of countries to which the Transferable Account System has been extended are in no way affected by the new arrangements.

It may be concluded that the Belgian, Netherlands, and Portuguese Supplementary Agreements conform with Article 8(ii) and Article 10(ii) of the Anglo-American Financial Agreement which provide that the United Kingdom will impose "no restrictions on payments and transfers for current transactions" and will make sterling balances released or otherwise available for current payments "freely available for current transactions in any currency area without discrimination" by July 15, 1947.

It will be of interest to follow the actual working of the Supplementary Agreements. The fact is that these facilities have been extended to countries which are comparatively short of sterling for trading purposes with the sterling area and whose authorities have agreed to exercise exchange controls on capital movements, to prevent transfers "which do not serve direct and useful economic or commercial purposes" and in general to supervise Transferable Accounts in a manner commanding the confidence of the British authorities. The question may be raised, therefore, as to whether the introduction of the Transferable Accounts System represents only a liberalization of the use of sterling balances, achieved through a shift of controls, or the termination of restrictive and discriminatory practices in current financial and monetary transactions.

Limited American Banking Services in Germany — Hans J. Dernburg

In February the American Express Company was authorized by the War Department to conduct limited banking services for American personnel stationed in Germany. It is believed that some of the large commercial banks in New York will ask for similar permits. The American Express Company was represented in Germany before the war by a subsidiary established under German law: the American Express Company G.m.b.H., with offices in Berlin, Hamburg, and Munich. It was the first to apply for a license authorizing limited banking services.

The authorization confines the company's activities to servicing American personnel, which until recently had no facilities for personal banking other than those provided by the Army itself. Nonetheless, the licensing of the American Express Company may be of wider interest because it may be the first step toward resumption of private banking transactions with Germany on a broader scale. In this connection it may be recalled that, early in February, the Assistant Secretary of War, Howard C. Petersen, expressed his belief in the "policy of encouraging commercial banks to make business loans /in Germany/ under Government control and supervision".

The license to the American Express Company takes due account of the system of foreign currency control introduced in the American Zone in mid-September 1946. At that time the issue of Allied Military Mark currency was discontinued in that area and since then American personnel has been paid in Military Payment Certificates denominated in dollars. The certificates are for exclusive use by United States authorized personnel1/ in United States

1/ Authorized personnel is defined to include the following principal groups: Military and Naval personnel of the United States Government; civilians who are citizens of the United States employed directly, or indirectly through contractors, by the military and naval establishments; civilians who are citizens of the United States employed directly by the United States Government, when authorized by the theater commander; dependents of personnel included in the three preceding groups as approved by the theater commander. It includes, moreover, personnel employed by organizations working for the benefit of the members of the Armed Forces of the United States, such as the United Service Organizations, American Red Cross Clubs, etc. Enemy nationals are specifically excluded. For further details see War Department Circular 256 of August 23, 1946.

military establishments. Disbursing officers may convert the Certificates in amounts not exceeding legitimate holdings into mark currency and also into other dollar instruments. A conversion of mark currency into Military Payment Certificates, however, is not permissible.

In line with the new procedures, the American Express Company will be authorized to accept deposits on dollar account from authorized personnel in the form of Military Payment Certificates and other dollar instruments only, while no provisions are made for accepting deposits in mark currency. Again, withdrawals for use in Germany are limited to Military Payment Certificates, except that, under special regulations, travelers checks1/ may be issued to the personnel and payment made by drawing on their dollar accounts. Remittances from the United States Zone to the United States or other designated countries are authorized if they are paid for in Military Payment Certificates, or in dollar instruments or by drawing on a dollar account with the bank. No authorization was given to exchange Military Payment Certificates or other dollar instruments for marks or to issue marks against dollar accounts. It is explicitly stated that the exchange of Military Payment Certificates for marks will continue to be effected exclusively by the disbursing officers of the Army or their agents.

The American Express Company, moreover, was authorized to "make dollar loans, repayable in dollars, for expenditures in Continental United States, in United States facilities in Germany and Austria, and for other purposes if specifically approved by the Theater Commander, to include expenditures in Germany or other European countries." Such loans, however, can be granted only to, and on behalf of, United States authorized personnel.

In addition to selling travelers checks, the American Express Company is authorized to sell foreign currencies, in accordance with special procedures, to sell war savings bonds, to provide safekeeping and tax service, and to act as general depository of public moneys of the United States.

1/ The American Express Company, before the present license was issued, was operating in Germany on a limited scale selling travelers checks and rendering the general services of a travel bureau.

Argentine Fiscal Policy

Robert A. Rennie

Since the Revolution of June 4, 1943, the Argentine Republic has adopted a system of economic controls characteristic of a planned economy. By direct government action including a policy of autarky and forced industrialization, it has sought to isolate itself from the effects of economic fluctuations abroad. To carry out such a program, the Government has extended its activities in all directions and has multiplied its expenditures. It has increased old taxes and tapped unexpected new sources of revenue. Its fiscal policies have had profound social and economic effects, not only as a result of the inflationary tendencies unleashed by large budgetary deficits, but also from the influence of spending upon the level and distribution of real income.

Fiscal Policy and Inflation

The budget of a country cannot be considered in isolation from the rest of the economy. It is not enough that government finance remain neutral in its impact upon the flow of income payments. One of the main purposes of budgetary policy should be to restrain the inflationary or deflationary pressures that tend to promote disequilibrium in the national economy. When analyzed from this point of view, budgetary practice in Argentina has been seriously deficient.

Throughout the war, with a large surplus of exports over imports, income payments were far in excess of the flow of available goods. From 1943 through 1945, for example, the physical volume of goods and services produced rose only 3.3 per cent whereas the means of payment soared by 47.4 per cent. The Central Bank, until its nationalization, issued Gold and Foreign Exchange Holding Certificates to the banks to sterilize the excess reserves created and thereby prevented a serious expansion of loans to the public. However, such measures could not, of themselves, reduce the high level of deposits which were the result of the favorable balance of payments.

To absorb the surplus means of payment directly, the Central Bank attempted to issue Certificates of Participation in National Securities to the public. The net sales of these Certificates were small, however, since the Bank could not absorb purchasing power by selling them to the public at the same time that the Government was selling bonds to meet its requirements. The only result of such a policy would have been to reduce the number of potential investors in Government bonds and thus to force the Treasury to sell securities to the banks. Thereby, the means of payment absorbed through sterilization operations would have been immediately recreated. Thus, indirectly, the Government prevented adequate measures to halt the pressures causing a rise in prices.

The direct impact of Government policy upon inflationary pressures was much more serious. During the war period, the Government could have pursued a policy of budgetary surpluses. By a well-designed tax program, it could have withdrawn the excess purchasing power at the points of maximum inflationary potential and from the sectors least in need of the scarce imports and raw materials. Instead, in its official budget accounts, it pursued a policy of deficit financing which was particularly pronounced during the late war years.

The rapid increase in government outlay has outstripped the rise in national income of the country. A study prepared by the Central Bank of Argentina reveals that the State is absorbing an increasing share of the disposable income of the country. In 1942, government expenditures represented only 18.4 per cent of such income; in 1945, the proportion had increased to 29.2 per cent. The following table presents a summary account of federal finance from 1935 to 1947.

Budgetary Deficits of the Argentine Federal Government
(In millions of pesos)

Year	Expenditures	Receipts	Current deficit
1935	1014.9	862.4	152.5
1936	1052.2	874.3	177.9
1937	1222.9	993.0	229.9
1938	1276.8	980.5	296.3
1939	1460.6	1015.2	445.4
1940	1316.6	963.8	352.8
1941	1367.1	910.4	456.7
1942	1526.1	1001.7	524.4
1943	1761.3	1024.5	736.8
1944	2411.7	1404.6	1007.1
1945	2759.3	1491.2	1268.1
1946	3227.5	1769.2	1558.3
1947	3444.4	2654.0	790.4 a/

a/ Not including extraordinary military expenditures, which amounted to 581.4 million pesos in 1946.

To determine the total inflationary impact of the Government's spending policy, it is necessary to deduct from the current deficit the surplus revenues of the extra-budgetary accounts plus the net absorption of government securities by the public. Unfortunately, such data are complete only from 1943, but since the major expansion in government activities came within this period, its analysis will be significant.

Inflationary Impact of Government Spending
(In millions of pesos)

Year	Current budgetary deficit	Less: surplus of autonomous agencies	Less: bonds sold to the public a/	Total deductions	Net addition by Government to flow of payments
1943	736.8	318.8	547.0	865.8	-129.0
1944	1007.1	593.0	235.0	828.0	179.1
1945	1268.1	525.8	202.0	727.8	540.3
1946	1558.3	923.0	200.0(est.)	1123.0	435.3

a/ Assuming the public also bought all the bonds issued by the provinces, municipalities, and the mortgage banks.

It is obvious that government spending did not reach dangerously inflationary proportions until 1945, although there had been previous deficits in the current budget. It might be argued that if bonds had not been sold to the public by the Government, the funds so derived might have remained in idle balances. This, however, is not true, for the Argentine Securities Commission was in this period rigidly limiting private security issues in order that government bonds might find a market as much outside the banks as possible. If such securities had not been issued, their place would have been taken by private issues and the inflationary pressures would therefore have been no different.

The Level of Real Income

In any economy, as long as full employment is assured, either by unlimited investment opportunities or by government fiat, there is a tendency for the total volume of private capital formation to be determined by the volume of savings diminished by the surplus in the balance of payments and the deficit in the total government accounts. In Argentina, therefore, the volume of private capital formation in the next few years will be determined largely by government policy, either directly through the impact of its tax policy upon savings and through the size of its government deficit or indirectly through its exchange control and state trading policies.

A rise in total output in a country such as Argentina can come in two principal ways: either through an increase in the total capital available for productive purposes or through improved utilization of existing land, labor, and equipment. In its present stage of industrial development, Argentina can increase its national income most rapidly by increasing the production and import of durable producers goods and by applying the techniques and processes that are being used in the highly industrialized nations. Such an increase in the rate of capital formation requires an equal increase in the volume of savings available for capital outlay. In Argentina, however, the Government, instead of acquiring productive goods which would induce a permanent rise in national income, has diverted savings to the purchase of armaments. The ratio of military expenditures to total federal outlay rose from 20.6 per cent in 1940 to 44.3 per cent in 1946. If the Government continues to absorb for itself in sterile enterprises the productive powers of the nation, the national income actually may be depressed in the future.

Even the recent repatriation of foreign investments may not prove to be advantageous to the economy in the long run. The railroads and public utilities for which the Government has spent large segments of its foreign exchange resources earned only a low annual return on the capital invested, and, therefore, the dividend payments did not cause a severe drain on Argentina's foreign exchange. Argentina is not in any real sense a mature country. Foreign capital still can be used profitably for the development of the "capital intensive" industries which require large imports of equipment and materials. On the other hand, its present and future foreign exchange assets might be reserved for the less "capital intensive" industries whose annual savings of foreign exchange would be high in relation to the capital required. Such an industrialization program would seem to offer greater opportunity for expanding national income than the policy currently being applied.

Such development could take place in the poorer areas of the country and in those agricultural sectors which have had their relative income reduced by the industrialization program of the Government. The concentration of public and private expenditures on the development of industry in the vicinity of Buenos Aires has given that region a disproportionate share of the wealth and income of the country. To correct such grave maladjustments, there exist several expedients for the Argentine nation. It might further diversify its production, stimulate industry in the interior provinces, and reorganize its land tenure.

Yet the need to diversify the economy is leading to a concentration of many economic and political controls in the hands of the central government. Federal control has grown through the expansion of administrative functions (education, public works, social welfare, and centralized tax collections) and of economic controls (regulatory commissions, state trading monopolies, banking and capital controls, and foreign exchange regulation).

The growth in the powers of the central government in Argentina is part both of the tradition of public administration in Spanish countries to which Argentina is returning and of the present world trend in economic planning. If these controls were used with skill and vision, they could greatly aid Argentina in achieving the high and stable national income which the abundance of its resources and the admirable qualities of its people can make possible. But several eminent Argentine economists maintain that the Perón government has given little evidence that it can integrate the economic policy of the country and at the same time satisfy the basic need for administrative flexibility and personal freedom. They state that its policies are driving the country into economic and political isolation, and that unless the course can be reversed, it will have serious repercussions upon the future prosperity of the Republic.