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Liquidation of Netherlands Dollar Assets.....	1
Recovery of Production and Foreign Trade in the Netherlands East Indies.....	7
British-Italian Financial Settlement.....	14
Economic and Financial Developments in Czechoslovakia.....	18

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Liquidation of Netherlands Dollar Assets

Robert W. Bean

On May 9 the Netherlands Government filed with the Securities and Exchange Commission a registration statement covering a prospective issue of \$20 million at 3-3/4 per cent for 10 years. At the same time that these preparations are being made to obtain dollars in New York, an issue of \$100 million at 3 per cent for 40 years is being offered by the Government to Netherlands investors in Amsterdam. The latter issue can be bought only with proceeds from sales of dollar securities in the United States, and is intended to encourage such sales. If successful, it may appear to be not only a good compromise solution to the Netherlands' dollar problem, but also the cheapest source of borrowed dollars. Actually, however, these are dollars already within the reach of the Government.

The dollar problem of the Netherlands has centered on the question of what to do about the huge holdings of Netherlands private investors, probably amounting to more than one billion dollars. One of the most persistent foreign applicants for long-term dollar credits, the Netherlands Government has long been embarrassed by the size of these holdings. In this country the view has been taken that before obtaining foreign loans, the Netherlands Government should draw on the country's own dollar resources. It has been loath, however, to requisition private

holdings. Recently, discouraged by the failure to secure adequate dollar credits, the Government has made a series of rather timid maneuvers intended to encourage voluntary liquidation of dollar investments. Of these, the latest is both the most ingenious and the most likely to have some success. This note attempts to estimate the value of the Netherlands marketable dollar assets, and to review the efforts made by the Netherlands Government to finance the deficit in the country's balance of dollar payments.

Value of Holdings

The census of foreign-owned assets in the United States, made by the Treasury Department after such assets were blocked, revealed Netherlands holdings of \$977 million, as of June 14, 1941. In addition, Department of Commerce data indicated that United States bearer bonds located in the Netherlands probably amounted to \$139 million, making a total of \$1,116 million. These assets fell into the following categories:

Deposits and currency		\$205 million
Securities: Bonds, government and corporate	156	
Common stocks	269	
Preferred stocks	31	
Other securities	<u>1</u>	459
Interests in controlled enterprises		336
Miscellaneous assets		<u>116</u>
		\$1,116 million

Changes in the amount of Netherlands short-term dollar balances since June 14, 1941, are indicated in Table 1. It will be noted that the figures reported by the Treasury census in June 1941 were about 16 per cent higher than the regularly reported figures in the same month. A similar degree of incompleteness may exist in the regular figures for later dates.

Table 1  
Netherlands Short-Term Dollar Assets  
in the United States  
(In millions of dollars)

Date	As reported by Treasury census (TFR-300)	As reported to Federal Reserve Banks		
		Total	Private	Official
June 14, 1941	205			
June 11, 1941		176	136 a/	40 a/
February 28, 1946		282	217	65
January 31, 1947		212	173	39

a/ Estimates, based in part on detailed figures for 2nd Federal Reserve District.

In order to arrive at an idea of the value of Dutch-held securities on more recent dates than June 1941, it is necessary to take account of net purchases or sales and of changes in market prices. An attempt is made here to do this for February 12, 1946, the date on which blocked Netherlands accounts in this country were released, and for April 1947, when the decision was made to issue the \$100 million loan in the Netherlands.

Table 2  
Estimated Value of Dollar Securities Owned by Persons  
in the Netherlands  
(In millions of dollars)

Type of security	June 1941: reported value	February 1946		April 1947	
		Price index	Estimated value	Price index	Estimated value
Bonds, government and corporate	156 <sup>a/</sup>	114 <sup>b/</sup>	178	111 <sup>b/</sup>	173
Common stocks	269	181	487	155	409
Preferred stocks	31	118	37	111	34
Other	1	n.a.	1	n.a.	1
	459		703		617
Less net sales <sup>b/</sup>			7		67
Net estimated value			696		550

a/ Average of price indexes for high-grade bonds and for medium- and low-grade bonds.

b/ For February 1946, as reported to the Federal Reserve Banks. For April 1947, as reported in Netherlands SEC registration statement.

Note: Price indexes, using June 1941 as 100, are derived from series computed by Standard & Poor's Corporation.

The figure of \$696 million for February 1946 (Table 2) is confirmed by data given in the Netherlands' SEC registration statement. According to the statement, the figure for that month would be \$690 million, after deducting \$350 million of shares in Shell Union Oil Company (February 1946 market value), which were included by the Treasury census of 1941 under "interests in controlled enterprises".<sup>1/</sup> For February 1947, the registration statement gives the figure of \$561 million.

Efforts to Avoid Liquidation

Prior to February 1946, when Netherlands-owned private dollar assets were unblocked, it was not possible for the Government to draw on these assets. Arrangements were therefore made for dollar credits. In the autumn of 1944 the Government negotiated a 3-year credit of \$100 million against gold with a New York banking group headed by the Chase National Bank, and a formal agreement was signed on February 8, 1945.

<sup>1/</sup> It has been confirmed that the total figure of \$1,140 million, which appears in the advance prospectus, is a typographical error and should be \$1,040 million.

In August 1945, the Netherlands Government approached the Export-Import Bank, indicating that total credits of \$500 million might be required. Apart from the fact that liquidation of Netherlands dollar holdings was then unfeasible, it was apparent that the Government would be reluctant to follow this course when it became possible. In order to discourage suggestions that this procedure might reasonably be demanded before credits were granted, the argument was advanced that liquidation of Netherlands holdings would have a disturbing effect on the New York stock market.

On September 11, 1945, the Export-Import Bank authorized two long-term credits of \$50 million each to the Netherlands Government.<sup>1/</sup> In November an additional \$35 million short-term credit was taken out against gold, this time from the Federal Reserve Bank of New York. Meanwhile negotiations were conducted with a group of New York banks in an unsuccessful effort to obtain an unsecured commercial credit of \$200 million, half of which would be used to repay the earlier \$100 million advance against gold. Inquiries were also made into the possibility of issuing bonds in the New York market, but the underwriting firms stated that an attempt at that time would be premature. A new approach was then made to the Export-Import Bank for a long-term credit of \$400-500 million, but the un-freezing of the Netherlands dollar accounts was then imminent, and this conjuncture of events brought to the fore the issue of liquidation of private dollar holdings.

Despite the fact that on October 10, 1945, the Government had issued a decree which included authority for the Netherlands Bank, with the approval of certain cabinet ministers, to requisition private holdings of foreign exchange and foreign securities against compensation to be determined by the Bank, the Government was disinclined to make use of this authority. Its view appears to have been based on a number of considerations: (1) the hope that dollar credits could be obtained at lower cost than the yield from dollar investments, (2) the desire to rebuild Amsterdam as an international financial center, and (3) the fear that outright requisitioning of private holdings would not be politically expedient.

It is difficult to assess the relative importance of these motivations. It is true that the Government might have hoped to borrow, e.g., \$400 million in this country at, say, 3 per cent (thereby incurring annual interest charges of \$12 million), and that the current average yield on an equal amount of American stocks may have been, say, 5 per cent (thereby providing the Netherlands with an annual income of \$20 million from this source), but would this difference alone explain the great reluctance to sell share holdings? If the yield on American stocks were to continue over a period of 20 years at present rates, the cumulative difference in costs of financing by the two methods would be significant, but current dividend payments are at an unusually high level, and within the period of the credit the difference might well be reduced or even eliminated.

The Government's desire to reestablish Amsterdam as an international financial center is a more elusive matter. With the decline of trading in American securities in London, owing to the heavy liquidation

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<sup>1/</sup> The loan agreements were signed on September 22 and October 31, 1945.

of British holdings, the Amsterdam Exchange might hope to achieve pre-eminence in Europe. This would bring in foreign exchange to the Netherlands in the form of brokerage fees and arbitrage profits, but it is difficult to estimate the relative importance of such earnings; one would not suppose it to be great. Apart from actual foreign exchange earnings, there is the prestige attaching to such a position, and this may have carried some weight with the Netherlands Government.

Neither of these considerations appears so impressive, however, as the Government's obvious reluctance on political grounds to requisition private holdings. Long after it had been realized that adequate dollar credits would not be available, the Government was still casting about for new means to encourage voluntary liquidation, despite the very slow pace at which this proceeded.

The loan negotiations in early 1946 were far from successful from the Netherlands point of view. Instead of the \$400-500 million in long-term credits which was sought, the Export-Import Bank granted only \$200 million, of which half was to be repaid within one year and the remaining half within two years with the expectation that repayment would be made from the proceeds of liquidation.<sup>1/</sup> The principal reason for the United States' refusal to grant long-term assistance was the availability of dollar resources owned by Netherlands nationals. Dollar balances alone on February 28, 1946, totalled \$282 million, of which \$217 million was privately owned. The Netherlands officials assured our Government that they intended to requisition these cash balances, but no indication was given that security holdings would be utilized.

Having failed to secure a long-term credit from the Export-Import Bank, the Netherlands Government in April 1946 again approached Kuhn, Loeb & Company with a request to issue to the public a loan of \$50 million. A draft registration statement was completed July 23, contemplating an issue of 25-year bonds in that amount, but the slight break in the bond market which occurred at that time discouraged the underwriters from putting the issue on the market, and it was not until after the success of the Norwegian issue in April 1947 that preparations for a second attempt were completed.

As early as March 1946, the Netherlands Finance Minister announced that a loan would be sought from the International Bank as soon as it began operations. In October a letter was sent to the Bank indicating the Government's intention of applying for a loan of \$500 million, and formal application for \$535 million was filed on April 8, 1947.

With no prospect of securing long-term dollar credits at an early date, the Netherlands Government resorted to further use of the country's gold resources (by means of short-term borrowing against gold which ultimately had to be sold), cutting its holdings by half, to about \$205 million, during the year ending April 1947.

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<sup>1/</sup> Authorized on March 20, 1946, and loan agreement signed May 1, 1946.

Encouragement of Voluntary Liquidation

Meanwhile, the prospect of having to repay the \$200 million short-term Export-Import Bank loan during 1947 and 1948 prompted the Government to reconsider its attitude towards liquidating dollar investments. In March 1946 the Ministry of Finance had made a cautious announcement that, "In view of the difficulties which seem to exist in obtaining credit, it will be necessary to sell private assets in the United States. It would please the Government most if the owners of these private assets would voluntarily liquidate them." This announcement immediately brought reproofs from the Amsterdam Stock Exchange Association. In April 1946 dollar and sterling currency and balances owned by Dutch nationals were ordered to be sold to the Netherlands Bank, but there was apparently widespread disregard of the order.

Voluntary liquidation of security holdings did not become practicable until after September 19, 1946, when the Netherlands Bank announced that technical preparations had been completed for the certification of Dutch-owned United States securities, required under the terms of the unfreezing agreement with the United States Treasury. The sale of certified securities was permitted on the New York Stock Exchange, and it was required that the dollar proceeds be turned over to the Netherlands Bank against payment in guilders, 60 per cent in free money, and 40 per cent on blocked account (in contrast with 50 per cent on blocked account in the case of proceeds from the sale of domestic securities). At about the same time, the capital increment tax law was enacted, providing for a levy of 50 to 90 per cent on wartime capital appreciation. As a further spur to voluntary liquidation of dollar security holdings, the postwar date used in computing the tax was set at either December 31, 1945, or the selling date. In view of the fact that security prices had fallen considerably since December 1945, in some cases the tax liability would be greatly reduced if the securities were sold.

The sale of dollar securities on the Amsterdam Stock Exchange was not permitted, because this would have allowed considerable profit-taking and adjustments of position among Netherlands investors without resulting in the realization of any dollar exchange. Sales could only be made in New York, and the dollar proceeds had to be delivered to the Netherlands Bank. The Finance Minister's refusal to permit trading in dollar securities on the Amsterdam Exchange, together with his statement on October 9, 1946, that he "would not shrink from instituting drastic measures" to compel liquidation if necessary (he had just returned from the United States where he had pressed for conversion of the \$200 million Export-Import Bank credit into a long-term loan), caused the Amsterdam stock brokers to "strike" on October 10 by refusing to trade. Two days later the Amsterdam Exchange was permitted to announce that trading in dollar bonds would be resumed within a few days. This concession to the Exchange was hedged about with restrictions: only bonds were admitted to trade; sales could be made only to buyers who would resell in the United States within two weeks; the bonds were deliverable to American purchasers only if accompanied by a Netherlands Bank certification not more than one month old; and the dollar proceeds had to be turned over to the Netherlands Bank. On March 10, 1947, American shares were admitted to trade in Amsterdam on the same conditions.

On March 13, 1947, Finance Minister Liefstinck stated that he would continue to rely as long as possible on voluntary liquidation. His latest scheme, referred to at the beginning of this note, was to borrow dollars from the private holders for a period of 40 years at 3 per cent. The novel feature of the plan, announced on April 12, is that the Government thereby incurs no dollar obligation as to either interest or principal; both are to be payable by the Government in guilders at the current rate of exchange on the date payment is due. The lender is thus guaranteed against depreciation of the guilder, and the Government is relieved of a dollar burden. The only persons eligible to subscribe are those who can offer dollars from the sale of American securities, or those who have already delivered such dollar proceeds to the Netherlands Bank and who are therefore permitted to subscribe in guilders.

The most recent statement of the Government's policy appeared in a White Paper of April 23, 1947:

"Although the Netherlands enjoys a good reputation among all potential creditor countries, the possibilities for taking up such credits are rather narrowly limited. The unstable political situation in Europe, among other things, is causing reticence. . . . The Government has always been of the opinion that a voluntary liquidation of Netherlands-held American securities should be given preference over forced liquidation. In view of the fact that there are of necessity certain technical disadvantages to a forced requisitioning of securities, it has taken the stand that such action should only be considered after it has become apparent that voluntary liquidation will not provide sufficient dollars."

One may question whether the technical disadvantages of forced requisitioning equal the political disadvantages. Compulsory registration of all holdings of securities, ordered in November 1945 and completed in April 1947, unless widely evaded, should have provided the Government with adequate information for enforcing requisition. Figures are not yet available here to indicate the degree of success achieved by the dollar loan in Amsterdam, but one may suppose that the chief incentive for Dutch investors to switch from American securities to the new bonds is the threat of ultimate requisitioning if the loan does not succeed.

Recovery of Production and Foreign Trade in  
the Netherlands East Indies

John B. Churchill

The Netherlands Indies is a tropical archipelago extending more than 3,000 miles from the northwestern tip of Sumatra to the eastern border of Dutch lands in New Guinea. The densely populated island of Java, supporting roughly 820 persons per square mile of its area, produces rubber, sugar, and tea for export. The so-called outer provinces, of which Sumatra is the largest in area and population, are even more important than Java as a source of raw materials for the world market.

Under the Linggadjati (Cheribon) Agreement, signed March 25, 1947, the Dutch now recognize the Indonesian Republic as the de facto government of Java, Madura, and Sumatra. The Dutch and the Indonesians have expressed the intention of forming a United States of Indonesia, under the Dutch crown, to include both the Republic and the Dutch-ruled outer areas. So far the Dutch and Indonesians have reached no agreement in regard to joint control of foreign trade and exchange and the return of foreign-owned properties within the Republic to their former owners.

Before the war the Netherlands Indies imported most of their finished consumers' goods, including large quantities of foodstuffs, and nearly all capital goods. Normally it had large export surpluses created by the outflow of primary products.

The slow pace of the Dutch reoccupation, coupled with the outbreak of the Indonesian Revolution immediately following the Japanese surrender, permitted only an insignificant volume of exports in 1945. The following table shows for the principal export items (1) the prewar importance of the Indies' contribution to world trade, (2) the value of legitimate exports from reoccupied territory in the first nine months of 1946, and (3) the quantitative recovery of each important group of exports in 1946, excluding smuggled goods. Commodities are listed in the order of their importance by value as exports in the base period 1937-39.

<u>Commodity</u>	<u>Percentage of world exports in 1937-39</u>	<u>1946 value of exports, Jan.-Sept. (000's U.S.\$)</u>	<u>1946 physical volume of exports as percentage of 1937-39 annual average<sup>a/</sup></u>
Rubber and gutta percha	36.2	14,200	14.3
Petroleum, petroleum products and coal	-	1,276	2.9
Petroleum (crude)	2.8 <sup>b/</sup>		
Tin and tin ore		7,310	23.0
Tin	16.7 <sup>b/</sup>	-	-
Sugar	5.1 <sup>b/</sup>	9	.008
Tea	16.8	203	1.1
Copra	28.6	2,700	10.1
Tobacco	-	376	2.0
Drugs and spices	-	2,651	4.9
Cinchona	88.0 <sup>b/</sup>	-	-
Pepper	83.4	-	-
Fibers	25.0 <sup>c/</sup>	720	2.4
Palm oil	23.0	-	-
Coffee	5.2	272	2.1
Tapioca products	-	56	.47
Animal products and manufactures	-	230	2.7
Other		2,047	
Total		32,050	

<sup>a/</sup> 1946 volume figures for all commodities except rubber, petroleum, tin, and copra were estimates arrived at by adding 1/3 to figures for the first nine months. In those four commodities twelve-month figures were available.

<sup>b/</sup> Percentages of world production.

<sup>c/</sup> Refers to hard cordage fibers only.



Only rubber, tin, and copra exports showed an appreciable recovery in 1946. It is difficult to say how far the recorded statistics understate the total volume of trade including illegal exports from Republican territory. For some commodities--tin, for example--smuggled exports were of no importance. In the case of rubber, however, it is believed that smuggled exports far exceeded recorded figures.

The chief impediment to the revival of the Netherlands Indies' trade inheres in the fact of divided control: the Dutch control the principal harbors, and the Republicans control areas in Java and Sumatra which before the war supplied 75 per cent of the archipelago's exports. Following the return of the Dutch to the Indies, virtually all foreign trade, both import and export, became temporarily a government monopoly--a situation which facilitated and simplified the strict control of foreign exchange. Trade in all export products except rubber, tin, and copra, and in several categories of imports, has been returned to private channels, subject, of course, in the case of exports to continued licensing and exchange and price controls. The Government allocates scarce foreign exchange among essential imports according to schedules of priority. Imports into Republican territory are sanctioned, with the exception of military equipment. Articles which may be imported into Republican areas only under special license include transportation and communication equipment, fuels and lubricants, and gold, silver, and currencies.

Under trade controls promulgated January 28, 1947, the exportation of "estate" produce from the Netherlands East Indies (including Republican territory) is prohibited unless covered by an export permit issued by the Netherlands Indies Government. In all of the islands the following are classified as "estate" products: cinchona bark and quinine, tea, palm oil, machinery and parts, land vehicles and parts, petroleum, lubricating oils, and coal. Gold, silver, and Netherlands Indies currency are considered to be in the same category as "estate" products. In addition to these, coffee, rubber, tobacco, and fibers are classified as "estate" products in Java and Madura, and gambier, rubber, tobacco, and fibers in the northern quarter of Sumatra. This listing would prohibit the export of all commodities which conceivably could have originated on estates. All of these items are considered to be the property of the plantation companies and therefore not at the disposal of the Republicans. Exports from Indonesian harbors of "native", as opposed to "estate", produce is permitted, provided it is duly cleared with the Dutch authorities. A measure of the probable effectiveness of these regulations--at least with respect to the Sumatra-Malaya trade--is the past inefficacy of the Dutch naval blockade: the American consul at Singapore states that Sumatra was the source of over 55 per cent of all raw materials imported into Malaya in the period August through October 1946, implying further that practically all of this resulted from clandestine trade with the Indonesians.

Two factors of a general nature continue to affect adversely the volume of produce available to the Dutch for export. (1) The short supply of "inducement" goods, without which the natives not only refuse to sell their produce but will not engage in production, has been a strong limiting factor, particularly in the output of rubber and copra. To alleviate this shortage the Netherlands Indies Government planned to purchase nearly \$53 million of consumer items in 1946, but only one-seventh of this amount had

been acquired by the end of June, the latest date for which figures are available. (2) Due to political factors impeding the resumption of trade and the continuing shortage of inter-island transport, many former areas of specialized output for export which were forced to become self-sufficient in food production during the occupation have remained so. Land and labor have thus been removed from production for export.

The islands' transportation facilities were severely impaired in the war. Losses of native shipping in the vital inter-island and coastal trade were especially heavy. The ocean-going merchant fleet also suffered severely. Damage to shipping is estimated at U.S.\$57 million.<sup>1/</sup> Reconstruction costs of the Netherlands Indies harbors will amount to about \$95 million.<sup>2/</sup> Great quantities of United States Army surplus materials acquired for this purpose in 1946 were not immediately available for use due to the inability of the Dutch to ship them to points where they were required. Storage space in Dutch-held ports had been reduced in various cases by 25 to 90 per cent of prewar capacity. The cost of rebuilding civil aviation, including aircraft and fifty airfields, is estimated at \$23 million.<sup>2/</sup> Six hundred miles of railways and more than 7,000 units of rolling stock were lost on Java and Sumatra. Railway rehabilitation is expected to cost at least \$60 million, while the cost of highway and bridge repairs is estimated at about \$115 million.<sup>2/</sup>

To meet payments abroad in 1946, earnings derived from exports and shipping services were supplemented by drafts on credits accumulated before the war and new credits made available by the Netherlands, Canada, and the United States. The debit balance of the Netherlands Indies Government with the Netherlands Treasury increased by 123,049,000 guilders (U.S.\$47 million). No data are available on other Dutch credits to the Indies. Total short-term assets held in the United States rose from \$113.7 million to \$127.1 million between December 31, 1945, and December 31, 1946. Gold under earmark here remained unchanged. For the purchases of Canadian exports Canada extended a loan (October 1945) of Canadian \$15 million, of which \$5.4 million was expended up to January 31, 1947. The United States extended an CFLC surplus property credit of \$100 million on July 11, 1946, of which \$68.3 million had been contracted for or received by the end of the year. In August the U.S. Commodity Credit Corporation, seeking to stimulate the production and export of copra to relieve the world shortage of fats, entered into a "copra agreement" with the Netherlands Indies Government, making available to the latter a \$15 million credit for the purchase of boats, equipment, and "inducement" goods. In January 1947 Australia granted a funding loan of Australian £7.5 million (U.S.\$24.4 million) to cover goods and services provided by Australia during the war and expenses of the Indies Government agencies in Australia.

The following discussion of the principal export commodities gives indications of the extent of their availability to the Dutch at the present and in the near future.

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<sup>1/</sup> Netherlands Chamber of Commerce in New York, Holland Rebuilds, No. 25, p. 23.

<sup>2/</sup> Idem, No. 24, pp. 21-22.

## 1. Rubber

The potential rubber production of the Netherlands East Indies was not greatly or permanently impaired during the period of Japanese occupation. Of the western-owned plantations, almost all of which were located in Java and Sumatra, predominantly controlled by the Indonesian Republicans and only slightly accessible to the Dutch, approximately one-tenth were destroyed by the Japanese. It is anticipated that at least two years will be required following restoration to their previous owners before the plantations may reach their prewar capacity. Recovery will depend primarily on future guarantees of protected development rights to plantation owners, the actual cost of rehabilitating war-damaged areas, and the labor problems encountered.

The great majority of the small native-owned farms, contributing roughly one-half the prewar output, have remained intact and may be presumed to be capable of their prewar production. Since most of them are also within Republican-controlled areas, their produce is likewise for the greater part unobtainable by the Dutch. It is believed that clandestine exports from Indonesian territory to Malaya greatly exceeded legitimate exports in 1946. Roughly 95 per cent of an estimated 80,000 tons of stocks in the islands at the end of the war were located in Republican territory. Legitimate rubber exports from the Netherlands Indies in 1947 are optimistically expected to reach one-third the 1937-39 annual average.

The Netherlands Indies Rubber Administration, established to rehabilitate rubber cultivation in the Indies and the only legal agent for the purchase and export of rubber, extends financial aid and equipment to both estates and individual Indonesian cultivators. Inadequate transportation of both materials and labor to the plantations and raw rubber from them continues to inhibit the complete revival of production.

## 2. Petroleum and Coal

The petroleum industry sustained major damage during the war. The most productive fields remain in Republican territory.

Before the war the Palembang field in southern Sumatra contributed 67 per cent of the archipelago's total petroleum output. It is estimated that once the wells (90 miles in the interior) become readily accessible they can be restored to partial production within three months. Complete reequipment of refineries, now underway, will require two years. It is known that the Indonesians are producing and refining oil in southern Sumatra in amounts sufficient to meet the needs of that portion of the island.

The Balikpapan and Tarakan fields in Borneo produced 21 per cent of the prewar total. These fields were accessible to the Dutch, and repair work was commenced in 1946. Production at the end of the year was running at 30 per cent of the 1939 rate. Tarakan crude constituted 67 per cent of the Dutch shipments of petroleum and petroleum products in 1946. Facilities at Balikpapan were found to require complete rebuilding.

The remaining oil fields, located in east Java, New Guinea, Madura, Celebes, and Ceram, contributed an insignificant fraction of the 1946 output.

It was necessary to import coal into the Netherlands Indies in 1946. The Indonesians control the greatest coal reserves of the islands (in Sumatra). Their current rate of production is not known.

### 3. Sugar

All of the Netherlands Indies' sugar is produced in Republican-controlled areas of Java. Sugar processing capacity was cut to 35 per cent of prewar by the Japanese who reduced the number of sugar mills from 120 to 51. The great majority of these are progressively deteriorating through lack of operation. Only 3.5 per cent of the average annual output in the period 1937-39 was produced in 1946. The Netherlands Indies Government has estimated that Java can produce 1 million tons of sugar (two-thirds of the 1937-39 annual average) in 1949 if the interior is accessible to Europeans in 1948. To achieve this goal estimated reconstruction goods valued at U.S.\$37,600,000 would have to be imported and 51 mills put in operation.<sup>1/</sup>

In spite of an international shortage, as of January 1947 between 800,000 and 1,500,000 tons of sugar were held by the Indonesian Republicans in the interior of Java. Increasingly strict enforcement of the Dutch naval blockade has reduced smuggled sugar exports to insignificance. Outside the Republican areas the supply of sugar has been exhausted, and the Dutch are obliged to support their army with imports from Cuba and Hawaii.

### 4. Tin

The electrical plants and mining equipment on the three tin-producing islands, Bangka, Billiton, and Singkep, were found to be severely damaged. The majority of mines, however, were practically intact. All three islands are now held by the Dutch. The great majority of the Chinese labor force having already returned to the islands, increased production for the present is largely a question of reequipment. Output in 1946 was 20.5 per cent of the 1937-39 annual average. Exports exceeded production by 2,300 tons since they included stocks found after the Dutch return. The output anticipated in 1947 (about 30,000 tons) is equal to the average prewar output.

### 5. Tea

It is estimated that 50 per cent of the tea industry's productive capacity was intentionally destroyed by the Japanese. Tea plantations were in most cases converted to growing cotton and vegetables since tea was easily obtainable from China. Damage to estates is estimated at around U.S.\$40 million. Only four of the 350 tea-producing estates and factories in Java and Sumatra, the almost exclusive sites of the industry, were working under Dutch control in April of this year. Many others are operating under the Republican administration, but little is known of production figures or stocks available for export.

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<sup>1/</sup> The Indonesians claim that enough cane was planted in 1946 to yield 300,000 tons of sugar in 1948. Dutch estimates are one-sixth to one-third of this, based in part on the very small known reserves of young plants.

On Java, which formerly supplied three-fourths of the Indies' tea, about 30 per cent of the prewar acreage was destroyed by the Japanese. Except for the few estates on which production was maintained, the tea-growing area has deteriorated through neglect. In addition, nearly half the tea factories were damaged, dismantled, or totally destroyed. N.E.I. officials estimate that it will require at least a year to recover production even on those estates found in fair condition when restored to their owners.

#### 6. Copra

Copra production centers chiefly in areas reoccupied by the Dutch. These areas contributed roughly 85 per cent of total copra exports before the war, and their potential was unimpaired in the course of the Japanese occupation. During 1946, the stimulation of copra production, the purchase of copra from the natives and its delivery at ocean ports was in the hands of the Netherlands Indies Government Copra Administration. The primary task faced by the Administration is the provision of daily necessities ("inducement" goods) for areas in which the bulk of the population is engaged in coconut cultivation. Since the export copra market disappeared during the occupation, distress is especially severe in districts where 75 per cent or more of the population is engaged in the copra industry.

Although 130,000 tons were available for export by the Dutch in 1946, exports were limited to 54,000 tons by a war-caused shortage of small craft necessary in the transportation of copra from outlying districts to ocean ports. This factor, it is anticipated, will complicate exportation of the 200,000 tons expected to become available in 1947.

#### 7. Others

During the Japanese occupation, practically all of the great tobacco areas on Sumatra's east coast were converted to the growing of other produce by dividing the large plantations into small patches and apportioning them among the natives. It is doubtful now whether these lands can be returned to large concessions.

Cinchona capacity was undamaged by the war; production was increased by the Japanese to whom its quinine derivative was a necessity. Current production is retarded by the lack of labor and necessary chemicals.

On the island of Bangka, prewar source of almost all the world's white pepper, only 0.5 per cent of the pepper trees remained standing in mid-1946. Three or four years will be required to restore production. From Sumatra, a greater producer of pepper of all varieties, considerable smuggled exports are drawn to Malaya by high prices there.

The area planted in oil palms, located almost entirely in Sumatra, was reduced by 16 per cent to make way for other crops.

British-Italian Financial Settlement

F.M. Tamagna and A.O. Hirschman

On April 17, 1947, the United Kingdom and Italy concluded a post-war financial settlement consisting of three Agreements: the first on current payments, the second on wartime accounts, and the third on Italian prewar assets and debts.

The Payments Agreement

The Italian Agreement follows in general the "supplementary agreements" signed by the United Kingdom with Belgium, the Netherlands, and Portugal in February 1947,<sup>1/</sup> but also contains provisions drawn from the "principal agreements", made by the United Kingdom with various European countries. This combination offers a new pattern which British authorities may intend to propose as the basis for the forthcoming settlements of sterling balances. These are the four major parts of the Italian Agreement:

Currency Payments. The Italian Agreement is unilateral in that it provides for (a) that the pound sterling only (and not the lira) be the currency of payment between the sterling area and Italy; and (b) that the Ufficio Italiano Cambi (the Italian agency administering foreign exchange and exchange control) open a sterling account (Italian account Number 1) with the Bank of England; and Italian residents be allowed to open "Italian accounts" (upon designation by the Bank of England) with British banks, but not for reciprocal lira accounts to be opened by the Bank of England and British residents with Italian banks. In this the Italian Agreement follows the pattern of the United Kingdom agreements with Austria, Finland, and Hungary, but differs from United Kingdom agreements with other European countries.

Minimum Balance. The Ufficio Italiano Cambi agrees to maintain a minimum balance of £10 million in its (Number 1) account with the Bank of England. While the principle of the minimum balance is part of the Agreement itself, the figure of £10 million was agreed upon through an exchange of letters accompanying the Agreement. This is significant, since a reduction in the amount of the minimum balance is thereby rendered possible without amending the Agreement itself.

In accordance with the terms of the U.S.-U.K. Financial Agreement, any release from the balance will have to be effected in a non-discriminatory and non-restrictive manner with regard to current transactions with other currency areas. Such releases, however, are unlikely to take place unless Italy's balance of payments with the sterling area becomes passive. The unilateral obligation on the part of the creditor country to maintain a minimum sterling balance is a new feature in United Kingdom agreements, and could be a precedent which the United Kingdom Government may intend to propose in lieu of unilateral blocking of accumulated sterling balances.

Exchange Rate. The Italian Government and the Ufficio Italiano Cambi agree to take the necessary steps to bring the buying and selling lira rates for pounds and dollars into line with the average pound-dollar rate fixed by the Bank of England. This is a unique provision, which is not to be found in any other European agreement. The reasons for it are

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<sup>1/</sup> See this Review, April 8, 1947, pp. 6-9.

the existence of multiple exchange rates in the Italian exchange system. Prior to the Agreement, the pound was valued in the legal Italian market, for the 50 per cent foreign exchange proceeds left to exporters, at a considerable discount vis-a-vis the dollar.<sup>1/</sup> As a result of the Agreement and the availability of sterling for payments to the dollar area, the lira-pound "free export" rate spontaneously rose to its cross-parity with the dollar.

Availability of Sterling. The United Kingdom Government agrees not to restrict the availability of sterling (in excess of the stipulated minimum balance) held by the Ufficio Italiano Cambi in its (Number 1) account with the Bank of England for transactions of a current nature with residents of countries outside Italy and the sterling area. The Agreement provides further that any sterling balance held by Italian residents in accounts with British banks can be freely transferred to other Italian accounts, including the Account Number 1 of the Ufficio Italiano Cambi and to residents of the sterling area, but not to residents of other monetary areas. These provisions are similar to those contained in the "supplementary agreements" with Belgium, the Netherlands, and Portugal, and make Account Number 1 of the Ufficio Italiano Cambi with the Bank of England a "transferable account" similar to the Argentina, Canada, Belgium, Netherlands, and Portugal transferable accounts.

The Italian Agreement covers an estimated £33 million accumulated by Italy after the liberation. Of this sum, £8 million are to be paid by the Italian Government to the United Kingdom Government in settlement of war claims and surplus property (see below) and £10 million are to be held by the Ufficio Italiano Cambi as minimum balance in its Account Number 1 with the Bank of England. This leaves about £15 million freely disposable, of which, however, £11 million are held in private hands (so-called 50 per cent private accounts held at authorized banks) and committed for purchases in the sterling area in accordance with Italian exchange regulations and the restrictions imposed as to the use of sterling before the Agreement was signed (requiring the use of export proceeds retained in private hands within two months from the date of receipt). Newly accruing sterling--after April 17, 1947--will be freely available for current payments in the dollar area.

Settlement of War Accounts

A second Agreement provides for a settlement of the wartime and postwar liabilities incurred by Great Britain toward Italy and vice versa.

The following items are listed as standing to the credit of Great Britain:

	(In millions of £)
Surplus property ceded and to be ceded	75.0
Supplies and services furnished to the Italian forces since Sept. 3, 1943	45.0
Fixed installations	8.5
Various	1.2
Total	<u>129.7</u>

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<sup>1/</sup> See this Review, March 11, 1947, pp. 11 ff.

The following items are listed as standing to the credit of Italy:

(In millions of £)

Net troop pay from June 1, 1946, to the withdrawal of British troops	12.0
Goods and services received during the same period by the British forces	13.0
Various	<u>1.25</u>
Total	26.25

Net Italian liabilities, therefore, exceed £100 million. As mentioned above, they have been settled by a payment of £8 million out of the sterling balances Italy has accumulated through net exports to the British Empire since liberation.

While the settlement is doubtless proof of British goodwill toward Italy, it must be kept in mind that Great Britain, unlike the United States,<sup>1/</sup> never has recognized any liability whatsoever for reimbursement of net troop pay and other military lira expenditures prior to June 1, 1946; this date seems to have been arbitrarily designated-- probably as the result of bargaining. Furthermore, the figure of £75 million for British surplus property in Italy probably represents the original cost of the property ceded to Italy rather than actual sales value. It may be noted that receipts from all sales of surplus property overseas during 1946 totalled only £64 million.<sup>2/</sup> By a special article of the Agreement the Italian Government assumes responsibility with respect to the United States for the value of any portion of the surplus property and installations ceded to Italy which was originally supplied by the United States through lend-lease.

Italian Prewar Assets

The United Kingdom relinquishes its rights under Article 79 of the Peace Treaty to retain all Italian-owned assets in Great Britain in order to satisfy any British public or private claims against Italy. It will retain only that part of Italian assets that is necessary to liquidate debts due from Italy to persons in the United Kingdom.

Therefore, upon ratification of the Peace Treaty by Italy, the British Government will release to Italy any Italian property other than liquid assets. The latter are to be transferred to the Italian Government which will hold them in a special account with the Bank of England to meet payments due to British creditors. A list of non-liquid property is to be communicated to the Italian Government which will indicate to the British Government which properties are to be liquidated to be added to

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<sup>1/</sup> The United States has transferred to Italy \$158 million for reimbursement of net troop pay and so far \$126 million for non-troop pay expenditures of the United States Army.

<sup>2/</sup> Statement of Chancellor Dalton in the House of Commons on March 13, 1947. Sales value of American surplus property ceded in bulk to Italy has been put at \$160 million.



the above account held at the Bank of England, which properties are to be released to their owners, and which are to be further considered with a view to determining their ultimate disposal. No specific agreement has been negotiated as yet with British owners of outstanding Italian bonds part of which (the 7 per cent Credit Consortium issue) fell due last March. Should the account to be opened at the Bank of England by the Bank of Italy be insufficient to meet Italian prewar debts, the Italian Government is under obligation to meet the deficit; in the opposite case, the balance of the account is at the free disposal of the Italian Government.

The total amount of Italian assets in the United Kingdom has been estimated at between £13 and £15 million of which £4.5 million are believed to be liquid. No estimate is available of Italian debts, but it is believed they will not exceed the liquid assets owned.

All in all, the main advantage of the Agreement to Italy is the fact that there has been a liquidation of the many financial questions which have been outstanding between that country and Great Britain. The granting of convertibility of sterling balances in anticipation of the July 15 deadline puts Italy in the same category as Argentina, Canada, Belgium, the Netherlands, and Portugal, and thereby gives it preferential treatment with respect to Spain--with which the United Kingdom signed, at about the same time, a payments agreement of the inconvertible type. However, press reports on the immediate material advantages and balance of payments relief obtained by Italy through the Agreement have been vastly exaggerated.

Economic and Financial Developments in Czechoslovakia

C.B. Rose, Jr.

Substantial improvement in economic and financial conditions in Czechoslovakia was recorded in 1946 despite the handicaps of postwar reconstruction, execution of the nationalization program, and a reshuffling of the population. The greatest strides were made in industrial production, the general level of which, even though still below prewar at the end of the year, had registered marked gains throughout 1946. Agricultural production lagged since yields were low and labor supplies inadequate. The monetary reform instituted in November 1945 worked satisfactorily with the Government's policy of "controlled inflation" in 1946, and the Government's financial situation proved to be better than had been anticipated.

Industrial Situation

Major difficulties were encountered in securing supplies of industrial raw materials, and shortages of labor also were felt, especially in some lines. Since Czechoslovakia is heavily dependent upon imports of raw materials, world commodity shortages and transportation deficiencies affected operation of industrial plants adversely. On the other hand, since the Czechoslovak industrial plant was largely preserved, the country was able to take advantage of the opportunities presented by the sellers' market in finished goods.

The Two-Year Plan announced in October 1946 went into effect on January 1, 1947. Its goal, to be reached by the end of 1948, is an overall increase in industrial production to 110 per cent of the 1937 level, and restoration of agriculture and transportation to the prewar status. Complete results for the first quarter are not available but according to official announcements have been "satisfactory".<sup>1/</sup>

One of the important conditions which may hamper fulfillment of the Plan is lack of enough and of the right kind of workers. The shortage of labor is caused in part by the Czechoslovak policy of expelling Germans, chiefly from the Sudetenland. This has been felt more acutely in certain industrial branches (like coal mining, glass, ceramics, and textiles) than in others. To a large extent, the expelled Germans were skilled workers and technicians whose replacement with untrained Czechs and Slovaks retarded production except in coal mining where extraordinary efforts were made so that output of coal in 1946 was nearly at the prewar level. In the first quarter of 1947, output of coal exceeded planned amounts as well as production in the comparable period of 1937. One factor holding down output throughout industry has been the lowered productivity of labor consequent upon war exhaustion and poor living conditions.

The shortage of workers is being overcome in part by a policy of compulsory labor for Czech citizens, by the repatriation of Czechs and Slovaks from many countries, by the importation of workers (from Italy, Bulgaria, and Romania), by moving Slovaks into areas vacated by

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<sup>1/</sup> Warnings have been issued by impartial observers that Czechoslovakian official statistics have been presented in such a way as to place the country's economic developments in the most favorable light.

Germans, and by shifting factories from Bohemia and Moravia to Slovakia where there is some excess labor supply. This latter development was slow in getting under way, but by March 15, 1947, it was reported that 90 plants employing over 5,000 workers had been moved, and that transfers were proceeding at the rate of one factory a day. One of the objectives of the Two-Year Plan is to bring about a better balance between the economies of the two sections of the country. In December 1946 it was stated that Slovakia had only about 15 per cent of the number of industrial workers employed in Bohemia and Moravia, and the value of its industrial output was only about 16 per cent of that of the rest of the country.

Raw material shortages were felt particularly in the iron-working, textile, and chemical industries. Stockpiles had been dissipated to such an extent that only a continuous flow of imports could keep plants working. By the end of the year, iron ore was coming in from Sweden as well as from Russia which was also supplying cotton, cotton and wool was arriving from the United States and the United Kingdom, and the chemical industry was able to operate at 80 per cent of capacity. Planned levels of output in the first quarter of 1947 have been exceeded in some instances, notably in production of pig iron, steel, and rolling mill products. In the case of steel, prewar levels of output have been passed. Operations of the leather and rubber industries also were very satisfactory in the first quarter of 1947. In the first two months of the year (data for the full quarter are not yet available), the most serious lags were experienced in building material production (cement, tile, and bricks) and in some textile lines, notably output of knitted and woven goods. The exceptionally severe weather was held responsible for the failure of building construction to approach planned volumes.

Throughout 1946, nationalization of industry proceeded at a rapid pace, and early in 1947 it was announced by the Government that the program had been completed. The degree to which industries were taken over by the State varied. In some instances such as rubber, alcohol distilling, and plywood manufacture, it covered all the factories engaged in these activities; in other cases the nationalized sector accounts for only 70 per cent or less of the output in the specific field. Nationalization was not accomplished without some detriment to production as plant management was reorganized and groupings and consolidation of factories effected. The uncertainties felt by private business regarding the extent to which nationalization would be carried dampened enterprise and probably held down production also in those factories not taken over by the State. In general, only the larger plants were taken over. Moreover, the establishment of State purchasing, marketing, and particularly of exporting agencies for the nationalized sectors of industries placed the private owners at a disadvantage. With the announcement that no further nationalization is contemplated, however, private enterprise may attack its problems with renewed energy.

#### Foreign Trade

Czechoslovakia ended the year 1946 with an excess of exports over imports in its commercial trade. The favorable balance of 4.1 billion Kcs.<sup>1/</sup> would not have been present, however, had UNRRA shipments

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<sup>1/</sup> One Czechoslovak crown (Kcs.) = \$0.021.

amounting to about twice that much been taken into account. These shipments were particularly important for certain industries which received raw materials, for transportation, and for certain foodstuffs in critically short supply in Bohemia and Moravia. It can be expected that the foreign trade picture will be less favorable in 1947,<sup>1/</sup> although some shipments on UNRRA account will be received to complete the program. In January and February of this year the excess of exports over imports continued, but in March the balance was unfavorable. In part this development was attributable to transportation difficulties which congested goods outside the Czech borders; reduced imports in the first two months of the year meant exaggeratedly large receipts in March. Nevertheless, there was a favorable balance for the first quarter of 454.6 billion Kcs., with imports totalling 5,006.4 billion Kcs. and exports 5,461.0 billion for the period.

The composition of Czechoslovakia's foreign trade in 1946 did not differ markedly from prewar. Raw materials and semi-finished goods accounted for 51 per cent of imports, and finished goods for 62 per cent of exports in 1947 compared with 57 per cent and 72 per cent respectively in 1937. Germany was no longer the important trade partner that it had been in prewar days, but still took 7 per cent of exports, although it supplied only .4 per cent of imports. Switzerland was the chief supplier as well as the chief market for Czech foreign trade, with Russia second and Sweden third.<sup>2/</sup> Czechoslovakia was able to export manufactured goods to markets which Germany formerly had supplied. The direction of Czech trade poses a problem for the future as raw materials must be found in western countries which under normal conditions are not the logical markets for the type of product (heavy industrial goods) upon which Czechoslovakia is now laying emphasis. The countries of the East and South which do offer a market for these goods cannot supply the raw materials which Czechoslovakia needs. Light industrial goods and handicraft articles probably will continue to be exported in considerable volume and for these western countries are the most likely buyers. A clue to the foreign trade policy of Czechoslovakia is contained in a statement of the Minister of Foreign Trade who declared that, to avoid unfortunate repercussions of a possible economic crisis in the West, it was necessary to strengthen commercial relations with Eastern European and Danubian countries. To this end, a series of long-term bilateral trading agreements have been or are being negotiated. At the same time the dependence of Czechoslovakia upon the West is not being overlooked. Under the Two-Year Plan, all foreign trade is to be controlled to conform to the requirements of the program. It has been estimated officially that the fulfillment of the Plan will necessitate imports of 35 billion Kcs. and exports of at least 30 billion Kcs. a year. This compares with total exports in 1946 of 14.3 billion Kcs.

Despite the surplus in commercial trade, Czechoslovakia probably has a deficit in its current account balance of payments.<sup>3/</sup> In this connection, the settlement of the question of payment of freight charges

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<sup>1/</sup> One official estimate anticipates a deficit of at least 4 billion Kcs. on merchandise account in 1947.

<sup>2/</sup> Presumably goods handled under processing agreements were not entered in the statistics. A considerable volume of such business is believed to have been handled on Russian account.

<sup>3/</sup> A deficit of 7 billion Kcs. (\$142 million) has been forecast for 1947 allowing for utilization of parts of credits granted to date.

across Germany is of importance. Czechoslovakia has requested that such charges be applied to the reparations due from Germany, while the Allied agreement precludes the payment of reparations from current production. At the same time, payment in dollars for these freight charges (required under existing ACC regulations) would absorb a large part of the available convertible foreign exchange.

National Bank Position

Nevertheless, the gold and foreign balances of the Czechoslovakian National Bank improved considerably during the year. This is shown on the comparative balance sheets reproduced below.

Table 1  
National Bank of Czechoslovakia  
Comparative Balance Sheets

	<u>12/31/45</u>	<u>12/31/46</u> (Million Cz. Kcs.)	<u>3/31/46</u>
<u>Assets</u>			
Gold	1,517		
Balances abroad	869	4,926	4,999 <sup>b/</sup>
Other cash	12,051	2,242	2,276
Loans and discounts	3,520	7,899	3,599
Other assets	<u>112,505</u>	<u>122,015</u>	<u>122,249</u>
Total	130,462	137,082	133,123
<u>Liabilities</u>			
Capital and reserves	558	558	655
Bank notes in circulation:			
New	24,233	43,590	42,904
Old	2,192	933	931
Deposits and other sight liabilities:			
New	2,187	10,068	9,133
Old	81,306	73,439	71,665
Other liabilities	<u>19,986 <sup>a/</sup></u>	<u>8,494</u>	<u>7,835</u>
Total	130,462	137,082	133,123

<sup>a/</sup> Of which certificates of indebtedness in circulation amounted to 9,918 million Kcs. These all matured by November 23, 1946.

<sup>b/</sup> Of which 1,769 million Kcs. in convertible currencies (including about 9,600 kgs. of gold); and 3,230 million Kcs. in nonconvertible currencies (including gold held in the pool at Frankfurt a/M).

It should be noted that the Bank includes in its reported gold holdings an undetermined amount of gold removed from the country during German occupation, part of which is now held in a pool in Frankfurt a/M.

The distribution among various claimants to this gold has not yet been settled. The fact that new bank notes in circulation almost doubled between the end of 1945 and the end of 1946 does not reflect inflation so much as a normal increase of circulation after the currency exchange and blocking program of November 1945 went into effect and economic activity began to revive. Old balances are being unblocked gradually, but no final settlement of this problem has yet been reached.

Price Movements

At the time of the monetary reform it was decided to equalize price levels between the various sections of the country at a level which would represent a three-fold increase compared with prewar. Various adjustments in individual prices have been made since then, but, as indicated in the table below, there has been no marked change in the general price level.

Table 2  
Development of Price Indexes  
(March 1939=100)

	<u>1937</u>	<u>1945</u>	<u>1946</u>		<u>1947</u> <u>Feb.</u>
			<u>Jan.</u>	<u>Dec.</u>	
<u>Wholesale Prices</u>					
Foods and foodstuffs	94	178	275	298	
Industrial manufactures	104	154	267	308	
General	97	165	267	301	299
Imported goods			293	344	
<u>Cost of Living</u>					
Workman's family					
of five	91	170	307	309	313
Clerk's family					
of four	90	157	277	288	293

Price reductions for certain consumer goods were effected recently, but at the same time some prices were raised. An announcement that the price of pig iron for steel mills and of rolling mill products and some finished ferrous metal goods had to be raised, attributed this move to unexpectedly high costs of production<sup>1/</sup> due, it was claimed, to high prices for imported ore. The existence of a seller's market has made it possible for Czechoslovakia to export goods hitherto at relatively high prices. There are signs that buyers are increasingly less willing to take any goods available without much consideration of price factors.

<sup>1/</sup> In this connection it may be noted that since the terms of compensation to former owners have not been settled and no allowance for this charge has been made on the books of the concerns affected, it is believed that prices have been based solely on costs of labor and materials without provision for amortization of plant and equipment. The revisions may reflect a change in accounting procedures of nationalized industries.

It has been reported that the results of the recent Spring Sample Fair in Prague were disappointing as foreign buyers were reluctant to place orders at present prices. To the extent to which price increases are applied to export goods, they will be even further discouraged. It has been noted, however, that prices quoted for export sometimes are below the domestic price of the same article. It remains to be seen whether the Government's proposed rationalization of industry and efforts to increase productive efficiency will bring about significant changes in the Czech price level.

An effort is being made to reduce the disadvantage at which the agricultural population finds itself because of the discrepancy in the levels of industrial and agricultural prices. At the same time, the Government has announced its intention of guaranteeing prices of agricultural products.

These price reductions are justified officially on the grounds that production increases have made a larger amount of goods available for the domestic market. Nevertheless, the recent announcement of the establishment of a price equalization fund of 6 billion Kcs. indicates that special measures are being devised to implement the Government's policy of price reduction. The price reductions are to be subsidized by the State which is to be reimbursed from the equalization fund; the resources of the latter will be derived from special turnover taxes on gross sales of various types of enterprises including retailers and jobbers. The law establishing the fund forbids the shifting of these taxes to the consumer. The necessity for setting up this elaborate mechanism to make possible reduction in prices within a limited area of the economy casts doubt on the economic wisdom of this policy.

#### National Finances and the Two-Year Plan

The budget adopted for 1947 is larger than that for 1946 which ended with unexpectedly favorable results. In the original budget estimates, expenditures had been placed at 64.0 billion Kcs. and revenues at 37.8 billion. Final results, however, were total expenditures of 50.3 billion Kcs. (13.5 billion less than anticipated) and total revenues of 42.5 billion (or 4.5 billion more than estimated). The deficit thus was only 7.8 billion Kcs. compared to an expected 26.0 billion Kcs. In part this was due to the inability of the Government to spend as much money for needed reconstruction as had been allowed for. In the current year, amounts to be expended under the Two-Year Plan for the expansion of the economy are included in the budget. Budget estimates for 1947 anticipate a deficit of 25 billion Kcs.

The national debt picture is not unfavorable despite an increase in the nominal amount outstanding (see Table 3). In consequence of the increase in the price level, the burden in 1946 actually is less than it was in 1937.

Table 3  
Czechoslovakian National Debt  
 End of year, 1937 and 1946

	<u>1937</u>	<u>1946</u>
	(Million Cz. Kcs.)	
<u>Internal Debt:</u>		
Long-term		24.3
Short-term		2.7
German occupation		45.8
Postwar		14.8
Other		<u>1.2</u>
Total	36.8	87.8
 <u>Foreign Debt:</u>		
Austro-Hungarian		2.4
Pre-occupation		9.1
Post-occupation		<u>9.5</u>
Total	7.2	20.9
 Grand total	 44.0	 108.8

Note: Interest paid in 1946 amounted to 2.5 billion Kcs. compared with 1.6 billion in 1937. Government efforts to reduce rates of interest paid have resulted in application of 3 per cent rate to all but the prewar internal debt. The average interest rate for all internal debt is now 3.44 per cent.

There has been considerable discussion regarding the capacity of Czechoslovakia to finance the Two-Year Plan. Expenditures under the program have been scheduled according to the table below.

Table 4  
Total Expenditures for Two-Year Plan  
 1947 and 1948

<u>For</u>	<u>Billion Kcs.</u>
Industry and handicrafts	25.38
Agriculture <sup>a/</sup>	5.21
Transport	15.09
Building construction and repair	14.00
Transportation and other public works	<u>10.20</u>
Total	69.88

<sup>a/</sup> About 70 per cent of the investment in agriculture will be spent for mechanization.



The Czechoslovakian authorities have stated that the amount of nearly 70 billion Kcs. represents approximately 15 per cent of estimated national income for the period. Total national income from current economic activities in 1946 has been placed at 148.1 billion Kcs. compared with 58.6 billion in 1937 when the price level was approximately one-third that of today. Thus national income in 1946 was about 85 per cent of prewar in real terms. It may be assumed that it will rise to about 160 billion Kcs. this year. The 1947 budget includes expenditures of only 11.9 billion Kcs. for the implementation of the Two-Year Plan. This is only a small part of the total investment necessary for the execution of the whole program, and only about 7 per cent of estimated national income. The conclusion may be drawn that the Czechoslovaks envisaged that the balance of the planned expenditure would be financed by foreign borrowing.

Czechoslovakia has applied for a \$350 million loan from the International Bank for Reconstruction and Development. Government officials have declared, however, that even if the loan is not received, the Two-Year Plan will be put through. In the light of the situation outlined in the preceding paragraph, the assumption would be justified that in such case the execution of the program would be slowed down considerably. Much of the proceeds of such a loan, if it were received, it is stated would be used for the purchase of machinery to modernize Czech plants and for raw materials. In the absence of such a loan, raw material imports (supplied to a significant extent through UNRRA in 1946) must be paid for with the proceeds of Czech exports, and it is claimed, Czech export capacity would be restricted by the necessity for depending upon obsolete and worn-out machinery. In this connection it is of interest that one informed foreign observer in Prague declares that in 1946 Czechoslovakia possessed the most diversified and potentially efficient industrial structure of any country in Europe, with the possible exception of Belgium, Sweden, and Switzerland. Not only had this industrial plant suffered less war damage, but many improvements made by the Germans in the interest of their war effort had remained to benefit the Czechs.

Although Czechoslovakia faces many problems in 1947, many of them stemming from the general world situation, the outlook is far from unfavorable. Reorganization and consolidation of the economy along planned lines has been carried to a point which it is claimed gives a solid basis for further progress. The fading out of the seller's market points to a necessity for the adjustment of Czech prices if Czech goods are to compete successfully in world markets.