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July 3, 1951

RECENT CHANGES IN GERMANY'S FOREIGN TRADE AND RAW MATERIAL POSITION -

Gordon B. Grimwood.

The continuing expansion of Germany's deficit vis-a-vis the European Payments Union caused Germany in February 1951 to suspend all "liberalized" import licenses to the EPU area; at the same time German authorities expressed grave concern as to whether imports from EPU countries under bilateral agreements could remain undisturbed. After consultation with the Managing Board of the Organization for European Economic Cooperation, Germany agreed to issue import licenses for both liberalized and non-liberalized imports through June 1951, based on a percentage of former trade. It was expected that imports from the EPU area in the second quarter of 1951 would average approximately $170 million per month, as compared with a monthly average of $202 million during the first quarter and of $211 million during the fourth quarter of 1950. At the same time the Bank deutscher Laender took steps to reduce the total volume of short-term credit outstanding in order to discourage the financing of excessive imports. By March 1951, these measures had succeeded in producing a small payments surplus vis-a-vis the EPU area; this surplus increased in April and May sufficiently to enable Germany to repay completely the special credit granted by EPU in the fall of 1950. April trade statistics, for the first time since the war showed a surplus on total account ($17 million); preliminary May statistics indicate that this surplus has increased to $23 million.

Exports to the dollar area, which have increased more than sufficiently to cover commercial imports from that area, together with payments from the EPU as a result of surpluses for April and May, have caused a sharp rise in German dollar reserves. This rise worries rather than pleases the German authorities, since the improvement in Germany's trade and payment position has been more the result of cuts in imports than of an expansion of exports. Although the value of exports has been increasing the value of imports has been declining far more sharply in comparison with fourth quarter 1950. Preliminary trade statistics for May indicate that, as compared with April, the value of imports declined further by $7 million, while the value of exports declined by $1 million. This development, considered together with the fact that the May volume of industrial production is not expected to rise above April figure, makes paramount the question of whether exports can be expanded rapidly enough to permit imports to rise again to a level which will support a continuing increase in the level of industrial production.

Foreign trade

A geographical breakdown of Germany's trade (see Table I) reflects the development of the EPU deficit in 1950-51. In the first quarter of 1951 this deficit was sharply reduced in comparison with the fourth quarter of 1950, although it remained slightly above the quarterly

average for 1950. Germany's payment surplus with EPU, as reported by the Bank for International Settlements, amounted to $45 million in April and $81 million in May, while the trade surplus with that area, according to preliminary statistics, amounted to $55 million and $78 million, respectively.

The EPU area, which for payment purposes also includes those sterling countries that do not participate in the European Recovery Program, accounted in 1950 for 64 - 70 per cent of Germany's imports. The proportion rose from quarter to quarter, but dropped slightly during the first quarter of 1951 and fell sharply in April. Correspondingly, the share of the Western Hemisphere in Germany's imports declined in 1950 from 25 per cent in the first quarter to 20 per cent in the fourth quarter; it rose slightly in the first quarter of 1951 and jumped to 32 per cent in April. These changes reflect the rapid increase in prices of raw materials from the non-participating sterling area and, to a lesser extent, Germany's efforts to shift imports first from the dollar to the EPU area in response to the credit facilities granted to Germany under EPU, and then back again to the Western Hemisphere in response to an increase in ECA allocations.

Germany's exports showed the opposite movement. The share of the EPU area declined from 79 per cent in the first quarter to 72 per cent in the fourth quarter of 1950, and remained little changed in the first four months of 1951. The Western Hemisphere, however, increased its purchases from 9 per cent of Germany's exports in the first quarter to 18 per cent in the fourth quarter of 1950 and maintained this position approximately in 1951. This development reflects not only the increased demand of the United States for industrial products resulting from the repercussions of the war in Korea, but also the success of the efforts of German exporters to reconquer the Latin American market. Unless Germany's export industries can increase their output by means of larger imports of raw materials, the rise in exports to the dollar area will be achieved to a large extent at the expense of exports to the EPU countries. Since Germany must purchase about two-thirds of its raw materials from the EPU area (including the non-participating sterling countries), the shift in exports contributes to the instability of Germany's position in EPU.

A breakdown of Germany's imports by major commodity groups and geographical areas (Table II) shows the significant role played by raw material imports. In the first quarter of 1951, these imports (by value) rose to a record level and, by volume, maintained the record reached in the fourth quarter of 1950. Between the first quarter of 1950 and the first quarter of 1951, they increased from 27 to 36 per cent of total imports by value, and from 27 to 29 per cent by volume. In April, however, they declined, compared with the average of the first quarter, about 4 per cent by value and 15 per cent by volume.

Imports in general have risen much faster in value than in volume (Table III); most of the rise (in absolute figures) occurred in shipments of producers' goods, i.e., raw materials and semi-finished products. The unit value of consumers' goods remained relatively stable, but the unit value of producers' goods rose 35 - 45 per cent between the first quarter of 1950 and the first quarter of 1951. The unit value of imports as a whole rose 18 per cent, as compared with a rise of only 8 per cent in the unit value of exports (Table IV). The deterioration in the terms of trade, as measured in this manner, amounted to almost 10 per cent.

Raw material position

The Federal Republic of Germany, in a report to the Organization for European Economic Cooperation, has submitted a schedule of production, import, export, and consumption of various key raw materials. This schedule, which is summarized in Table V, indicates that during 1950 stocks of certain basic raw materials were seriously depleted, particularly coal and coke, non-ferrous ores, and non-ferrous metals. Textile stocks increased very slightly, while stocks of raw rubber remained almost unchanged. These statistics omit several important categories of German raw materials and all consumers' goods; as far as they go, they would seem to show that reports of German inventory accumulations during the last half of 1950 were somewhat exaggerated. It is possible, however, that "consumption" includes, and "end stocks" exclude, inventory accumulation by processing and distributing agencies; in that case the figures would understate the amount of raw materials actually available to the German economy.

Table VI represents an attempt to project these raw materials positions to June 30, 1951, due regard being given to seasonal influences and to increases in industrial production. This method of projection leaves a wide margin for error, but it is believed that it indicates the trend of developments likely to occur unless the level of imports is raised. The concentration of projected short-falls in the non-ferrous metals industries is primarily the result of a 65 per cent increase in production in those industries between the first four months of 1950 and the first four months of 1951. On the other hand, the projected increase in coal stocks during the first half of 1951 would seem to indicate that German complaints about an excessive coal export quota may be somewhat exaggerated.

The German delegation to the OEEC has submitted an estimate of raw material positions as of the end of the second half of 1951[1] which indicates that small amounts of most of the important raw materials will be in stock as of the end of the year. A close examination of the detailed statistics reveals, however, that this position is based on drastic cuts in the consumption of many basic raw materials. The use

1/ "The German Import Program," OEEC. Doc. EC(51)28, 23 May 1951.

of raw rubber, for instance, is expected to be more than 50 per cent, and the use of basic non-ferrous metals is expected to be from 20 to 50 per cent, below that estimated for the first half of 1951, although production of all metals except copper is expected to be slightly increased. Imports of most raw materials is expected to be below the level attained during first half 1951. The deepest cuts in consumption of raw materials occur in those instances in which Table VI indicates short-falls for the first half of 1951, and the combined effect of increased production and reduced consumption is barely sufficient, in many of these cases, to permit a positive figure to be obtained. This German position paper, therefore, bears out the conclusion that a rising level of industrial production could not be expected at the present level of imports.

Further statistical evidence for the conclusion that the supply of raw materials is falling behind the rate of increase in industrial production is presented in Table VII. Since February 1951, the ratio of raw material imports to industrial production has been falling sharply below the 1949-50 average. This fall is the more serious since the heavy industries, which are expanding most rapidly, consume a particularly high proportion of imported raw materials and especially non-ferrous metals.

Conclusions

On the basis of the statistical evidence presented, it would seem that Germany's imports and stocks of raw materials are barely sufficient to maintain the volume of industrial production at the level attained during the first quarter of 1951. The increase in industrial production during April 1951 (which, according to preliminary, data did not continue in May) was apparently made possible by drawing down stocks of raw materials which are not being replaced; therefore, if the rate of increase in industrial production over 1950 is expected to continue, additional stocks of raw materials--barring the possibility of a substantial shift in utilization--must be attained by increased imports. The only alternative would be the closing down of many basic industries and a rapid increase in unemployment. While that alternative might help solve the balance of payments difficulties, it goes without saying that it cannot be seriously contemplated; least of all at a time when full production of all Western European nations is needed worse than ever before. It is to be hoped that the favorable development of Germany's trade and payments position over the last two months will make it possible to do away with many of the recently imposed import restrictions and that imports will be permitted to rise to the level needed to support the continuous expansion of Germany's industrial production.

Table I
Germany - Balance of Trade, 1950-1951
(Millions of dollars)

Areas	1950												1951					
	First Quarter			Second Quarter			Third Quarter			Fourth Quarter			Total			First Quarter			April		
	Imp.	Exp.	Bal.	Imp.	Exp.	Bal.	Imp.	Exp.	Bal.	Imp.	Exp.	Bal.	Imp.	Exp.	Bal.	Imp.	Exp.	Bal.	Imp.	Exp.	Bal.
EPU[1]/	387	282	-105	340	321	- 19	445	387	- 58	634	493	-141	1806	1483	-323	606	516	- 90	144	199	+55
West. Hem.	148	33	-115	141	41	-100	149	68	- 81	188	124	- 64	626	266	-360	194	122	- 72	83	49	-34
East. Eur.	23	27	+ 4	21	38	+ 17	31	31	--	39	33	- 6	114	129	+ 15	22	35	+ 13	7	12	+ 5
Other World	34	14	- 20	26	22	- 4	45	30	- 15	53	36	- 17	158	102	- 56	63	35	- 28	22	14	-8
Total	592	356	-236	528	422	-106	670	516	-154	914	686	-228	2704	1980	-724	885	708	-177	257	274	+17

1/ Including non-participating sterling

Source: Der Aussenhandel der Bundesrepublik Deutschland

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Table II

Germany - Imports by Area and Commodity, 1950-1951

(Value millions of DM; Volume millions of 1936 RM)

Period		EPU 5/ Commodity 1/	2/	3/	4/	Total	West Hemisphere Commodity 1/	2/	3/	4/	Total	Other World Commodity 1/	2/	3/	4/	Total	Total Commodity 1/	2/	3/	4/	Total
1950																					
First Quarter	Value	745	414	242	223	1625	387	169	28	39	623	119	81	30	11	242	1251	665	301	273	2490
	Volume	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	381	224	98	116	820
Second Quarter	Value	546	433	219	237	1434	268	245	40	43	595	97	70	19	9	194	911	747	277	288	2224
	Volume	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	283	239	87	119	728
Third Quarter	Value	837	453	294	291	1874	311	230	48	33	624	151	115	37	17	321	1300	798	379	343	2819
	Volume	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	405	251	115	155	926
Fourth Quarter	Value	1006	728	464	467	2666	396	272	82	40	789	150	158	61	18	386	1551	1157	607	525	3841
	Volume	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	461	307	166	224	1159
Total	Value	3134	2028	1219	1218	7579	1362	916	198	155	2631	517	424	147?	55	1143	5013	3367	1564	1428	11374
	Volume																1530	1021	466	614	3633
1951																					
Jan)		301	279	120	132	832	120	101	34	17	272	51	58	18	9	137	472	439	173	158	1242
Feb)	Value	330	294	111	138	874	103	87	28	12	230	52	44	17	5	118	486	424	156	155	1222
Mch)		-	-	-		838	-	-	-	-	310	-	-	-	-	110	461	477	163	156	1258
Total)						2544					812					365	1419	1340	492	469	3722
Jan)																	145	108	45	64	362
Feb)	Volume																153	101	37	59	351
Mch)																	136	98	38	59	331
Total)																	434	307	120	182	1044
Apr	Value					605					351					123	389	427	142	121	1079
	Volume					-					-					-	100	87	32	46	265

Notes: 1/ = Foodstuffs
2/ = Raw Materials
3/ = Semi-finished Goods
4/ = Finished Goods
5/ = Including non-participating sterling

Sources: Der Aussenhandel der Bundesrepublik Deutschland.

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Table III
Germany - Index of Imports, by Volume and by Value
(1936=100) 1/

Commodity	(1) Volume 1950 1st	2nd	3rd	4th	1951 1st qu.	(2) Value 1950 1st	2nd	3rd	4th	1951 1st qu.	Unit Value (2/1) 1950 1st	2nd	3rd	4th	1951 1st qu.
		quarter					quarter					quarter			
Foodstuffs	156	115	165	188	177	510	372	530	633	579	327	323	321	337	327
Raw Materials	80	85	89	109	110	241	263	284	412	478	301	309	319	378	434
Semi-Mfg.	80	70	93	134	97	241	227	307	491	394	301	324	330	366	406
Finished Goods	193	198	258	373	305	456	480	571	874	782	236	242	221	234	256
Total Index	116	103	131	163	147	352	312	397	541	525	303	303	303	333	357

1/ Quarterly averages
Source: Aussenhandels-Statistik der Bundesrepublik Deutschland

Table IV
Germany - Index of Exports by Volume and Value
(1936=100)

Period	Volume (1)	Value (2)	Unit Value (2/1)	Unit Value Imports / Exports
1950 - First Quarter	69	178	258	117
Second Quarter	82	211	257	118
Third Quarter	99	257	259	117
Fourth Quarter	129	342	265	125
1951 - First Quarter	126	352	279	128

Source: Aussenhandels-Statistik der Bundesrepublik Deutschland

Table V

Germany - Raw Material Position, 1950

Commodity 1/	Inventory 1 Jan. 1950	Change Jan-June	Change July-Dec.	Total Change	Inventory 31 Dec. 1950
Wool, Ummfg.	13.6	+ 5.4	+ 0.6	+ 6.0	19.6
Cotton, raw	34.4	+14.4	- 9.8	+ 4.6	39.0
Hides & Skins	17.4	- 0.5	+ 8.0	+ 7.5	24.9
Raw Rubber	12.9	- 3.1	+ 2.0	- 1.1	11.8
Hard Coal & Coke	3,730	-1,450	- 400	-1,850	1,880
Iron Ore	4,074	- 621	+ 935	+ 314	4,388
Manganese Ore	11	+ 7	+ 11	+ 18	29
Lead Ore 2/	28	-13.2	+ 2.9	-10.3	17.7
Zinc Ore 2/	54.5	-27.8	- 5.0	-32.8	21.2
Copper Ore 2/	52.4	- 3.1	- 0.9	- 4.0	48.4
Wool Yarn	1.6	+ 1.8	- 1.4	+ 0.4	2.0
Cotton Yarn	5.2	+ 6.0	- 5.6	+ 0.4	5.6
Copper	24.3	- 3.4	- 5.9	- 9.3	15
Aluminum	22.0	- 3.3	-12.5	-15.8	6.2
Tin	0.4	+ 0.5	- 0.2	+ 0.3	0.7
Zinc	22.9	- 1.4	- 7.0	- 8.4	14.5
Leather	5.9	+ 1.0	- 3.7	- 2.7	3.2

1/ In thousands of metric tons.
2/ Metal Content

Source? O.E.E.C. Document EC (51) 18, Addendum 4, 26 April 1951.

Table VI

Germany - Projected Raw Material Position as of June 30, 1951

(Thousands of metric tons.)

Commodity	Inventory 1 Jan. 1951	Imported Raw Materials: Production	Import	Export	Consumption	Inventory 30 June 1951
Wool, Unmfg.	19.6	1.5	45	2	49	15
Raw Cotton	39.0	0	146	2	159	24
Hides & Skins	24.9	38	39	-	80	22
Raw Rubber	11.8	0	60	7	99	-34
Manganese Ore	29.0	0	105	0	110	24
Copper Ore	48.4	0.6	54	0	96	7
Nickel	0.4	0.2	2	0	5	- 2
Tin	0.4	0.3	3	0	5	- 1
Produced Raw Materials						
Wool Yarn	2.0	47	4	1	62	-10
Cotton Yarn	5.6	159	5	2	200	-32
Leather	3.2	40	5	1	52	- 5
Hard Coal, Coke	1,885	59,202	2612	11,957	47,598	4,144
Iron Ore	4,388	5,842	2348	43	10,116	2,419
Lead Ore	17.7	24	13	0	61	- 6
Zinc Ore	21.2	34	23	0	81	- 3
Aluminum	6.2	26	4	3	58	-25
Zinc	14.5	68	6	1	110	-22
Copper	15.2	105	52	19	153	0

Note: Figures on raw material production have been projected for a six-month period on the basis of first quarter 1951 statistics, while import and export figures have been projected for the same period on the basis of January-April figures. The consumption figures are based primarily on the ratio of consumption to raw material imports during the first half of 1950 in the case of imported raw materials, and on the ratio of consumption to raw material production in the case of those raw materials primarily produced in Germany. The figures have been adjusted to take into account the increase in the production index of the appropriate manufacturing industries for the first four months of 1951 over the first four months of 1950; in the case of coal and coke, the increase in the general industrial production index has been used. Minus signs indicate short-falls in raw material supplies that would arise if the level of industrial production continued to rise at its present rate through June 30, 1951, and the level of raw material imports and production conformed to the projections.

Table VII

Germany - Volume of Industrial Imports and Industrial Production

(Average Oct. 1949 - March 1950 = 100)

Period	Industrial Imports (1)	Production 1/ (2)	Imports / Production (1/2)
1949			
1st Quarter	69 2/	86	80
2nd Quarter	86 2/	90	96
3rd Quarter	83 2/	91	91
4th Quarter	97	99	98
1950			
1st Quarter	103	101	102
2nd Quarter	105	109	96
3rd Quarter	117	119	98
4th Quarter	152	135	113
1951			
1st Quarter	137	135	101
January	(147)	(131)	(112)
February	(133)	(137)	(97)
March	(131)	(139)	(94)
April	114	143	80

Notes: 1/ Including power, excluding building, beverage, and tobacco.
2/ United States - United Kingdom zones only.

Sources: Der Aussenhandel der Bundesrepublik Deutschland, Monthly Report of the Bank deutscher Laender, April 1950, April 1951.

July 3, 1951

FINANCIAL STABILITY AND ECONOMIC DEVELOPMENT IN COMMUNIST COUNTRIES -

Edward Ames

The communist countries of Eastern Europe are all carrying out ambitious industrialization programs. These programs are in principle understandable since the countries in question are obviously "underdeveloped" by comparison with Western European countries as well as in terms of their own natural and human resources. At the same time, non-communist economists often feel that these programs are "unrealistic" or "excessive", while the governments of the communist countries themselves have frequently been forced to revise downward their periodic plans. The question of what might be considered a "realistic" development program has not been satisfactorily explored: in the communist countries discussion of the question is hampered by the fact that it is a political offense ("right-wing deviation") to suggest that any particular government program may be too large, and in non-communist countries discussion is often conducted on the basis of concepts which cannot be applied to a communist economy.

In a communist as well as in a non-communist economy, it is possible to distinguish between outlays for private and for public use and within both categories between outlays for present use (consumption) and outlays for future use (investment). In contrast to non-communist societies, however, all outlays for future use, private as well as public, are made by the State and its agencies, while outlays by individuals are restricted to current private use. Discussions of communist economic policy have usually been concerned with the relation between outlays for public and private use, or between outlays for present and future private use (consumption and investment), or between outlays for various kinds of public use (e.g., civilian and military), or between outlays for various kinds of future private use (e.g., light and heavy industries). These questions are not devoid of interest. This paper, however, is primarily concerned with the relation between present and future use as a whole without distinguishing between outlays for private and for public use. Since "development" is a major, if not the decisive, factor in determining the allocation of resources for future use, the sector of the economy concerned with outlays for future use will be called the Development Sector, and the part of the overall economic plan regulating the allocation of resources for future use will be called the Development Plan.

The following discussion will deal with the problem of formulating a concept of "stability" with respect to the Development Sector of a communist country. In this way, it will attempt to set forth a criterion for evaluating communist development programs.

Institutional structure of communist economy

Although unfortunate from most points of view, Soviet influence in Eastern Europe has had the desirable effect of simplifying the economist's task by creating a pattern of uniformity in the institutional structures of these countries. Private industry tends to be restricted by law to enterprises hiring less than a certain number of workers (in the Soviet Union, no private hiring is allowed, and private enterprise is limited to one person). The prevailing form of industrial ownership is by the State, although smaller units, chiefly in the agriculture, handicrafts, and service fields, are cooperative in nature. The state-owned enterprise is an independent administrative entity, with its own balance sheet and profit and loss account;1/ the enterprise, however, is considered as custodian of state property, rather than as the owner of the property itself. Legally, therefore, the rights and obligations of the enterprise concern only current production, and do not extend to fixed assets, which is under the direct jurisdiction of the State, acting through the Ministry of Finances. Any change (acquisition, construction, sale, or demolition) of fixed assets of the enterprise, however financed, is permitted only with the authorization of the Ministry, as representing the owner of the enterprise. The cooperative, on the other hand, is the property of its membership; although in fact property of cooperatives may be shifted from one jurisdiction to another, in theory it is done with the consent of the owners, who are supposed to be recompensed for any losses in their original investment. This distinction is not of much importance in terms of current operations -- where all enterprises have plans, are more or less subject to allocations programs, etc. -- but in terms of capital investment there is a significant difference. The state enterprise receives its fixed assets as grants from the State, whereas the cooperative must finance expansion out of accumulated profits or from long-term credit. There is no "payment" by the state enterprises for fixed assets, and although the State may authorize the enterprise to use its profits for construction purposes, rather than to pay them to the Treasury, the enterprise does not thereby become the owner of these assets in any juridical sense.

Sectors of communist economy

The communist economy may thus be divided into three sectors, which may be called the Development, the Enterprise, and the Consumer Sectors.

In the Development Sector, the principal directing agency is the Ministry of Finances, operating through the medium of the State (i.e. central plus local) Budget. This sector accounts for production of certain goods and services which are paid for out of State budgetary funds rather than the funds of enterprises. The range of such goods and services is considerable, ranging from defense equipment to schools and new factories.

1/ Certain types of enterprise are operated as "budget enterprises", with their gross revenue appearing as budget revenue and their gross expenditures as budget expenditures. These are primarily in service areas rather than in industry. For simplicity, they are disregarded here.

The construction of new factories, in particular, is centralized through the Ministry of Finances, which (a) approves a list of projects which may be constructed; (b) makes available from tax revenue the bulk of funds to be used to finance construction; (c) absorbs, by means of sales and corporate profits taxes, a considerable portion of the revenues of industry, in such a way as to channel convertible funds out of branches which it is not considered desirable to expand; (d) decides the size of the portion of the profits to be retained by individual factories already operating, so that some branches of the economy which the state wishes to develop may expand through self-financing; (e) by direct taxation and quasi-voluntary borrowing from the population absorbs that portion of the nominal purchasing power of the consumer sector not needed for the maintenance of the planned standard of consumption. In principle, there is no reason why the State should not finance the Development Sector by the creation of credits; in fact, this method is invoked only in times of extreme emergency.

In the Enterprise Sector; actual operations are conducted by enterprises, state and cooperative, which are subject to two sets of controls. The first, with which this portion of the paper is not concerned, represents direct controls over output, allocations, and techniques exercised by the ministry or economic agency to which the plant is responsible. The second represents financial controls administered by the Central Bank, which is the center for virtually all transactions among enterprises and also the only legal source of short-term commercial credit in the country.

In this sector of the economy lie the primary functions of the Central Bank. Its function is to control inventories, and it is able to do so for two reasons. First, newly formed enterprises are given a certain amount of working capital, but in general are not given enough to permit them to maintain their normal operations. The difference must be borrowed as short-term credit. Second, when an enterprise makes a sale, it is prevented from extending credit to the purchaser. On the one hand, the enterprise is perennially short of cash itself, and on the other, the Bank supervises the enterprises' accounts and can directly penalize it for such transactions by cutting down the size of its credits. By its ability to control inventories (by credit rationing), the Bank is able to influence industrial efficiency. A decrease in managerial efficiency will lead either (a) to an increase in stocks of raw materials if these are not absorbed by the plant as rapidly as desired by the State, or (b) a decrease in stocks of raw materials if such materials are wasted in the production process, or (c) to an increase in stocks of semi-finished goods, if the plant is not processing them as rapidly as it should, or (d) to an increase in stocks of finished goods, if, for example, the quality of output is so low as to make the products unsalable. In all these cases, a decline in efficiency will lead to a shortage of working capital. When the Bank, in the course of its supervision, discovers the difficulty, its power to limit credits, and hence to make impossible the completion of the production plan as ordered by the ministerial superiors of the given factory, serves as a means whereby the Bank can discipline the management of enterprises. Finally, by its supervision of all documents cleared through it, the Bank is able to ensure that legal wholesale price limits are observed.

The Consumer Sector includes the incomes and expenditures of the population as individuals. Direct control over this sector is exercised through the Ministry of Trade, which through its fixing of prices, variety, and quality of consumer goods, has control over the expenditures of the population, and the various agencies which control wage and piece-work rates.

Bank action affects this sector as the result of the so-called "cash plan". The State Sectors of the economy (i.e. the Development and Enterprise Sectors taken together) make payments to the consumer in the form of wages and receive payments in the form of consumer purchases at state stores, and of tax payments and loan subscriptions. Unlike transactions in the Enterprise Sector, these transactions are in the form of cash (bank notes) rather than of check and clearing transactions. There is a clear relation between the total output of a plant and the amount of wages it must pay out at any particular level of efficiency; hence there is a relation between cash out-payments by the State Sectors and total output (including the output of the Development Sector, which must also pay wages). On the other hand, given any investment program, level of inventories, and set of consumer habits, there is a particular amount of cash paid into the Consumer Sector which, if it is to flow back to the State Sectors so as to prevent an increase in the volume of notes in circulation, must be absorbed by a suitable retail trade program and by suitable taxes and loans.

Conditions of "stability"

Given this set of circumstances, it is possible to define "stability" in the communist economy from the government's point of view as a situation where the following conditions are met:

(a) The Government is able to complete its Development Plan;

(b) Current production is maintained at the planned level without any unplanned change in stocks, and without unplanned unemployment or overtime labor;

(c) Cash payments by the State Sectors do not exceed cash inflows by an amount more than the change in the willingness of consumers to hold cash at existing prices.1/

The first condition implies that the Government is able to obtain the necessary labor, materials, and managerial ability for its own requirements. Its ability to do so is, in part, a function of its ability to exercise direct controls over economic activity, but in part it depends upon the "realism" of the plan. By "realism" is meant the extent to which the plan makes successful allowance for indirect repercussions of events in the Development Sector upon the other sectors

1/ In fact, savings of individuals in Eastern Europe would appear to be small, and owing to shortages of goods, there is apt to be little desire to hold cash if purchases can be made with it.

of the economy. The second condition measures, in a real (non-monetary) sense, the extent to which the Development Plan is "realistic"; for if the Development Plan can be achieved only at the expense of the current production plan, the planning procedure must be considered defective. The third condition measures the "realism" of the planning procedure in financial terms. If the first two conditions are not met, the third may become impossible of attainment, as it may prove impossible so to manipulate retail prices, taxes, and government borrowing that cash inflow into the State Sectors will equal cash outflow. Similarly, a failure to satisfy the third condition will in turn affect the ability of the State to achieve the objectives of either its development program or its current output plan. What typically happens in such a situation is that prices rise on the "free market", where the farmer sells his surplus to the city dweller; cash flows into the countryside, the farmer's incentive to sell to the Government at low official prices is reduced, the supply of foods available in state retail trade is reduced, state revenue from the turnover tax and corporate profits is reduced, and in the extreme case money may not be available to finance by ordinary means the Development Plan. Within the cities, the incentive of the worker is reduced because of his inability to purchase anything with his cash income, and the entire structure of industrial discipline is threatened. This situation has been observed in the USSR in the early 1930's and again during the recent war; it has also been characteristic of other East European countries since the end of the war.

Conclusions

The foregoing discussion has treated "stability" as a problem in government planning. One element in this "stability" will be the "tastes" of the Government, that is, the balance which the Government strikes between its desires and capabilities in the preparation of the plan. The economic theory of private enterprise does not as a rule consider the need of the businessman to adjust his "tastes" to market conditions, although in effect this problem is implicit in the treatment of business strategy in some recent work.1/ It is, however, clear that if the Government is unable to meet its production plans, it must either take additional measures (imposition of tighter controls, labor discipline, rationing, et al.) or modify its plans. The use of the term "stability" in a sense comparable to its usage in economic theory would therefore demand that no such changes in plans or techniques of control be required.

The term "stability" does not, in particular, imply anything about the welfare of the population as represented by the standard of living. If the Development Plan is to be expanded, it may be quite possible for stability to be maintained through an appropriate increase in tax rates, loans, prices, and labor productivity, at the cost of a planned decline in the standard of living. It is true that if the standard of living declines too far, either revolution or collapse may occur; but they would be caused by the Government's wrong assessment of political and social repercussions of planned level of consumption rather than by intrinsic incompatibility of planned levels of consumption and production.

1/ See von Neumann and Morgenstern, "The Theory of Games and Economic Behavior", Princeton, 1944.