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REVIEW OF FOREIGN DEVELOPMENTS

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The Bond Limitation Plan in Canada

Robert A. Rennie

In its Annual Report for 1945, the Board of Governors of the Federal Reserve System presented several alternative proposals designed to prevent further debt monetization by the commercial banking system. One plan suggested that the Board of Governors be granted power to establish a limitation on holdings of long-term bonds by the commercial banks of the country. It was felt that such a plan might make the Board's monetary policy effective by restraining unnecessary creation of bank credit through the continued acquisition of government and other securities by the banks. At the same time, the market for short-term securities would be strengthened and the interest cost of the Federal debt stabilized by reducing the existing inducement to sell short-term securities to the Reserve Banks in order to purchase higher-yielding, long-term issues.

Canada adopted such a bond limitation proposal on March 1, 1946, in the form of a voluntary agreement between its ten chartered banks and the central banking authorities. The Canadian bond portfolio plan is primarily a change in form of an earlier agreement between the government and the chartered banks. Both agreements sought to accomplish the same ends, viz., to prevent a serious rise in interest cost to the government as a result of its borrowing from the banks, and conversely, to limit the earnings of banks derived from their increased holdings of government securities.

Agreement with banks on holdings of deposit certificates

On July 29, 1942, the Ministry of Finance announced the conclusion of a voluntary agreement with the chartered banks whereby they would purchase sufficient deposit certificates to meet the needs of the Treasury in the intervals between the public sale of Victory Loans. Deposit certificates are unlike any of the short-term government securities issued by the United States Treasury. They merely entitle the Dominion Treasury to a six-month deposit credit against which withdrawals can be made as needed. Initially, interest was paid at the rate of 3/4 of 1 per cent. The requisite amounts were distributed among the banks by informal arrangement.

The first difficulty with the agreement arose in November 1942, when it became evident that the increase in total cash requirements of the government could not be matched by a similar rise in receipts from taxation and public bond issues. As a result, it was arranged that only 205 million of the 645 million dollars outstanding of deposit certificates would be cancelled from the proceeds of the Third Victory Loan.

If the increase in public deposits resulting from government expenditures financed by security sales to the banks had been primarily of the non-interest-paying type, further complications could have been avoided. However, the Third Victory Loan had diverted only a relatively small amount of the assets held in the form of notice deposits. Previous issues had always absorbed most of the net gain in such deposits during the period between loan issues. Since notice deposits earned interest at 1-1/2 per cent, it was necessary that the banks acquire higher earning assets than the deposit certificates. Under these conditions, bank profits slumped 5.6 per cent in 1942 and 10.0 per cent in 1943.

During 1944 and 1945 the spread between notice and demand deposits was increased. Notice deposits rose 917 million dollars whereas demand deposits were up only 366 million. To reverse the earnings picture, the banks increased their holdings of longer-term government securities during the two years under consideration by 1,208 million. In the same period, their holdings of short-term governments declined by 249 million dollars. This fall in short-term securities was entirely due to government redemption of 815 million held by the chartered banks during 1945. It was with the proceeds of these redemptions that the banks were able to increase further their holdings of long-term bonds.

This shift in bond maturities overloaded the banks' portfolios with long-term securities. Even though a large proportion of the higher-earning assets were acquired late in the year, bank earnings rose in 1945 by 14.4 per cent. Moreover, the changes in the constitution of the federal debt increased the interest cost from 2.51 to 2.59 per cent in the fiscal year 1945-1946. There was nothing in the banking laws or previous agreements with the chartered banks which could correct the situation. It was in the light of these circumstances that the government concluded a new pact with the banks limiting their holdings of government bonds and applying restrictions to their earnings.

Agreement with banks on holdings of government bonds

The agreement between the government and the chartered banks consisted of three parts. They agreed:

a) That bank holdings of all Dominion government domestic bonds (including guaranteed issues) would not average more than 90 per cent of the amount of their Canadian savings deposits;1/

b) That earnings before income taxes on Canadian savings deposits would not exceed the cost of interest and other expenses of the "average" bank by more than 3/10 of 1 per cent of the amount of such deposits; and

c) That a voluntary "secondary reserve" of deposit certificates or Treasury bills would be made available to the banks that desired to invest in Dominion government securities beyond the 90 per cent limit. The rate of interest on deposit certificates was reduced from 3/4 to 5/8 of 1 per cent.

Canadian banking statistics fail to reveal any immediate changes caused by the agreement. The first provision did not force any liquidation of securities. Several banks, including the larger institutions, were at or near the 90 per cent limitation, while those below that figure held a higher proportion of provincial-municipal securities or had a larger volume of commercial loans. It was anticipated in Canada that they would not change their investment policies and, therefore, in view of the profit ceiling, would not increase their holdings of Dominion bonds in any greater proportion than the other banks.

However, the bond limitation provision does allow the banks to increase their holdings in proportion to any future increases in savings deposits. The experience during the balance of 1946 reveals that the banks took full advantage of this opportunity, for whereas notice deposits rose 299 million dollars, investment in longer-term Dominion Securities increased 304 million.

The profit limitation provision

The ceiling on earnings is in reality the only essential feature of the agreement. It insures that there will be a demand for the bonds of shorter maturity, since the permitted profit margin is lower than what would be earned if the 90 per cent quota were invested entirely in long-term securities.

The spread of 3/10 of 1 per cent on savings deposits was adjusted to the previous level of Canadian bank earnings on such deposits. Most banks were earning slightly less than the agreed basis, so that no major adjustment in the maturity distribution of the portfolios was necessary. Applying the

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1/ Savings deposits are defined as notice deposits other than corporation balances.

costs of the "average" bank to the individual bank instead of its own figures permits the more efficient bank with lower expenses to earn more than the 3/10 of 1 per cent standard, while the less efficient bank will earn less than the standard rate.

Since Dominion securities alone are included within the scope of the agreement, only the restriction on profits prevents the bond limitation requirement from becoming relatively ineffective. This drawback might have become serious in light of the limited supply of other issues, and the Dominion securities would have been at a disadvantage in the market. Such a movement would have reduced the differential in interest rates between public and private issues. With the profit ceiling, however, the banks have no incentive to replace shorter-term Dominion bonds with other issues, or even to purchase long-term non-Dominion securities beyond the 90 per cent limit. An examination of the banks' portfolios indicates that there has been only a slight increase in provincial and municipal issues, and while the increase in the category "other bonds, debentures, and stocks" has been relatively substantial, it is small in absolute amount and may be attributed to the increased supply of such securities arising from reconversion needs.

While the profit limitation provision helps to stabilize the cost at which the Treasury borrows, it does not prevent an increase or decrease of net return on capital to the banks as savings deposits fluctuate. The Canadians assumed that if the savings deposit business were being carried on by separate savings institutions and if they had capital equal to 5 per cent of deposits, then the net profit margin of 3/10 of 1 per cent on deposits would leave a net return on capital of 3.6 per cent after allowing for a corporate income tax of 40 per cent.

But the assumption of a fixed ratio between capital and deposits is unreal, for in Canada the ratio of capital and reserves to total deposits during the war ranged from 8.95 per cent on August 31, 1940, to 4.05 per cent on September 30, 1946. If we assume a percentage return on demand and other deposits equal to the return on savings deposits provided by the agreement, the return on capital would have varied from a rate of 3.36 per cent to 7.40 per cent between the two dates. In actual fact, the return on capital after taxes was 5.57 per cent in 1946 as compared with only 4.44 per cent during 1945.

The variation in bank earnings resulting from changes in deposits could be offset by several measures. The margin of net earnings on savings deposits might be inversely correlated with deposits so that as deposits rose, the profit margin would fall, and vice versa. The government might also require the banks to maintain a constant ratio between capital and reserves and savings deposits. This was the condition assumed in the Canadian example, and for the first time since the beginning of the war, the reserves of the chartered banks were increased by 40 million dollars at the end of the current financial year, or almost exactly 5 per cent of the increase in notice deposits since the date of the agreement.

The "secondary reserve" of deposit certificates

The provision of a "secondary reserve" of deposit certificates for investments beyond the 90 per cent limitation was designed to maintain the demand for this inexpensive and flexible source of government borrowing. In reality, if the profit limitation is effective there would seem to be no need for the arbitrary démarcation. Not only is a properly adjusted ceiling on earnings sufficient to insure a pôrtfolio whose maturity distribution would sustain the demand for all short-term government securities, but it would also tend to hold the market interest rate for commercial paper at the level of comparable government issues.

Even if there were neither a bond limitation nor a profit ceiling, there could be no incentive for the chartered banks to sell deposit certificates or Treasury bills to the Bank, since the former are inalienable and the latter are already held by the Bank. All the Treasury Certificates and six months, one year, and two year Notes are in the portfolio of the Bank of Canada as well. Because there could be no substantial expansion of bank credit from this source, the problem of debt monetization did not figure significantly among the reasons for the agreement with the banks.

Conclusion

Judged by its success in attaining the stated objectives--the limitation of bank earnings and low interest cost to the government--the agreement was not overly successful in its first ten months. Whatever advantages it has provided are due to the close and informal cooperation between the Treasury, the Bank of Canada, and the ten chartered banks in its administration. With over 14,000 banks operating under completely dissimilar competitive conditions, the United States could not rely upon voluntary cooperation. If a bond portfolio **plan** were to be formalized in statutory regulations in this country, a much more clearly defined formula than the Canadian agreement would be necessary to achieve the results sought by the Board of Governors.

United States Foreign Lending and Tariff Policy:
An Application

Robert W. Bean

It is well recognized by economists--and, one may hope, also by Congress--that a connection exists, or should exist, between our willingness to lend and our readiness to be repaid. We have signified by our sponsorship of the I.T.O. and the forthcoming trade talks in Geneva (and Mr. Vandenberg, for one, has given at least a tentative blessing) that we are prepared to consume un-American-made goods. In greatest measure, certainly, the size of our imports depends on our level of economic activity, but the height of our tariffs also has a substantial effect. Early in 1945 the Tariff Commission estimated, on the basis of a detailed commodity-by-commodity investigation, that the result of a 50 per cent reduction of our customs duties below the 1939 level would be approximately a 40 per cent increase in our imports of dutiable commodities, and better than a 20 per cent increase in our total imports. The decline in United States production for the domestic market, resulting from this injection of competition, was estimated at 2 per cent. These figures have no sanctity about them, having been originally subject to a wide margin of error and subsequently made less applicable by the evident fact that various assumptions now have to be modified, but they serve to indicate roughly the degree of significance which should be attached to United States tariff policy.1/

It should be useful to investigate not only the relationship between our tariffs and domestic production, as has been done by the Tariff Commission, but also the relationship between our tariffs and the ability of individual borrowing countries to meet their dollar obligations. As an example, a few not-very-precise figures may be given in the case of Belgium. In 1946, Belgium's import surplus from the United States approached 200 million dollars. During the present high-income period in the United States, availability and price are the chief limiting factors on our purchases of Belgian products. Price is steadily assuming greater, and availability less, importance. Even now, some diversion of Belgian **exports from** soft-currency to hard-currency markets might be achieved if the price barrier were removed. Belgium has experienced a considerably greater rise of internal prices during the war than have the hard-currency countries, and has only partly compensated for this difference by exchange depreciation. Belgian exporters formerly able to scale the American tariff well now find it more forbidding.

Diamonds--which enter the United States duty-free if rough or uncut, and are subject to only a 10 per cent duty if cut--now account for three-quarters of Belgium's exports to this country, whereas in pre-war years they represented but one-fourth to one-third of the total. Other Belgian exports are in many cases subject to much higher duties: e.g., coarse linens, 50 per cent; and cotton fabrics, up to 58 per cent. Glass and cement, now in great demand, are subject to specific duties, the burden of which has diminished somewhat as prices have risen; but the equivalent ad valorem rate on sheet glass in 1939 was 60 per cent, and it is likely that this is one of the items on which the Belgians will seek tariff reductions.

At Geneva, the United States delegates will have authority to concede reductions of 50 per cent below the rates existing on January 1, 1945. How would such reductions affect Belgian exports to this country? An indication may be found in the Tariff Commission's conclusions that if duties were reduced by 50 per cent, total United States imports of, e.g., coarse linens might be doubled; of cotton fabrics, increased by better than 50 per cent; of glass, by 50 per cent; and of cement, by 25 per cent. These figures were intended to apply to the post-transition period when availability would not be a limiting factor; they do not refer to imports from Belgium in particular. It is apparent, however, that a particularized study might be made which would provide a rough answer, and it does not seem unreasonable to suppose that an increase of, say, 15 per cent in total Belgian exports to the United States would be found possible on the basis of a 50 per cent cut in tariff duties.

1/ U. S. Tariff Commission, Post-War Imports and Domestic Production of Major Commodities (Report on S. Res. 341; 78th Cong., 2d sess.), 1945. Among the important assumptions were: 1) "that the currencies of the world will be stabilized at the same relative values as existed in 1939", 2) "that most exchange controls will have been eliminated in the post-war long-term period, and that those which are continued will be exercised in a non-discriminatory manner", 3) "that the relation between general price and cost levels in the different countries of the world will be about the same in the post-war long term as in 1939."

For a country with a post-war official dollar debt of 100 million dollars, and a perennial trade deficit with the United States, this would be a welcome addition to current earnings.

Value of Selected Dutiable Imports from Belgium in 1937, and Applicable Tariff Rates

Commodity group	Value of imports (millions of dollars)	Ad valorem duties (per cent)	Specific duties: 1939 ad valorem equivalent (per cent)	Estimated percentage increase in total imports of commodity if duty cut 50% 1/
Linen fabrics	5.2	50		100
Cotton fabrics	2.4	8-58		50
Jute cloth	.5	30-35		15
Iron & steel products	3.1	20 a/		20
Copper, crude & scrap	.5		45	b/
Cement	1.1		18	25
Coal-tar distillates	.8		45	50
Gelatin	.6		23-28	15
Films, in rolls	.5		18	50
Photographic paper, sensitized	.4	22½		10
Window glass	.5		60	50
Plate glass	.4		58	130
Precious stones	15.2	0-10		
Sub-total	31.2			
Other imports	33.2			
Total imports	64.4			

1/ As estimated for commodity group by Tariff Commission (op. cit.). Estimates based on pre-war price relationships and intended to apply to post-transition period.

a/ Average rate for a wide variety of products.

b/ Copper imports virtually excluded prior to the war by tariff; significant increase probable if rate reduced by 50 per cent.

Currency Troubles in Ethiopia J.H.F.

For almost two centuries the people of Ethiopia and other Middle Eastern countries have used a silver coin, the Maria-Theresa dollar, as their monetary unit. In 1945, the Ethiopian Government introduced a new currency, the Ethiopian dollar, officially based on gold, but actually pegged to sterling at the rate of 2 shillings (around 40 United States cents) per dollar. Payments fixed by law in Maria-Theresa dollars were to be discharged in Ethiopian dollars at the rate of 1 to 1; apart from these cases, the Maria-Theresa dollar was to be bought and sold at its bullion value.

The currency found acceptance in the capital, Addis Ababa, and some other trading centers, but the rural population continued to use the old coins exclusively. More recently, considerable amounts of these coins have been exported to other Middle Eastern countries. This development was unwelcome to the authorities, and especially to the (American) governor of the newly established State Bank. The State Bank has been trying to buy up all available Maria-Theresa dollars in order to be able to regulate its value, to increase the area of acceptability of the new currency, to repay the Ethiopian silver debt (lend-lease) to the United States, and perhaps also to participate in the profits from the export of these coins. Moreover, the outflow threatened to raise the domestic value of the coins in relation to the new currency, and thus to discredit the latter both in the domestic and the international market.

The Conquering Lion of the Tribe of Judah therefore issued a decree of November 29, 1946, which prohibited all private dealings in Maria-Theresa dollars as of December 29, 1946, and ordered all holders of such coins to sell them to an official Board within a period ranging from one month after that date for Addis Ababa to six months for rural districts. Trade in, or possession of, Maria-Theresa dollars after these dates will be severely punished, and informers will be rewarded.

The Maria-Theresa dollar contains five-sixths of a troy ounce (25.9 grams) of fine silver. The redemption price fixed by the decree is 1.50 Ethiopian dollars, or approximately 60 United States cents. The bullion value of the coin was around 75 cents as long as the market price of silver remained in the neighborhood of the price offered by the United States Treasury for domestically mined silver (90.5 cents per ounce). In view of the recent decline in the market price of silver, the bullion value dropped to 70 cents at the end of December 1946 and 59 cents at the end of January 1947. The present value is thus in line with the price fixed by the Ethiopian Government. It is very doubtful, however, whether the Ethiopian people expect the price of silver to remain at its present low level, and even if they do, whether they would prefer to hold paper money and token coins rather than the customary full-weight silver coin of the same value. It is therefore rather unlikely that the present decree will succeed where all former similar government actions have failed. The Ethiopian people may be expected to continue to use the Maria-Theresa dollar, and the main effect of the decree may well be the addition of a risk premium to the price of the coin, and therefore an increase of its value in relation to the official currency. The decree may thus hinder rather than promote the establishment of a national monetary system in Ethiopia.

Note on Poland's Coal Situation

Hans J. Dernburg

As a result of decisions reached at the Potsdam Conference, placing formerly German territories east of the Oder-Neisse rivers under Polish administration. Poland has become the third largest producer of hard coal in Europe, ranking after the United Kingdom and Germany. In 1938 Germany produced 186.2 million tons of hard coal, of which 31.2 million tons were produced in Silesia, now under Polish administration. Poland produced in the same year 38.1 million tons of hard coal. Adding to this the production of coal in German Silesia, production in the present Polish area was 69.3 million tons.

The following table shows the extent to which present coal output in the principal coal-producing countries in Europe approaches the prewar level. Polish production, at about 75 per cent of prewar, is at about the same relative level as that of Belgium and above that of the western zones of Germany and the Netherlands, but is below that of the United Kingdom, France, and Czechoslovakia.

Present Coal Output Compared with That of 1938 in Seven Leading European Countries

	Output in 1938	Present Output1/	Present Output in Per Cent of 1938 Output
	(Millions of metric tons)		
United Kingdom	230.0	205.6	89
Germany			
Western zones2/	151.4	68.8	45
Eastern zone3/	3.5	2.74/	77
Poland5/	69.3	52.0	75
France	46.5	47.7	103
Belgium	29.6	23.1	78
Czechoslovakia	13.8	15.3	111
Netherlands	13.5	9.1	67

1/ Output in November-December 1946 on an annual basis.
2/ British and French zones of occupation.
3/ Russian zone of occupation. Data for German production in 1938 excludes output of Silesia which is included under Poland.
4/ Based on October figures.
5/ Postwar area.

Poland's balance of payments position depends largely on the volume of coal production. According to Polish estimates, coal will account in 1947 for 67 per cent, in 1948 for 70 per cent, and in 1949 for 72 per cent of Poland's total exports by value. Moreover, these exports are of vital significance for the economic reconstruction of Europe. Data contained in the Polish Plan of Economic Reconstruction concerning coal output, domestic consumption, and surplus available for export are shown below:

Coal Data from the Polish Reconstruction Plan
(Millions of metric tons)

	1946	1947	1948	1949
Output	46	60	70	80
Domestic consumption	32	40	42	45
Available for export	14	20	28	35
Coal consumption per head of population in kgs. 1/	1,333	1,648	1,714	1,800

1/ The population figures used in the Plan are 24 million for 1946, 24.3 million for 1947, 24.6 million for 1948, and 25 million for 1949.

It is difficult to reconcile these data with Poland's coal commitments which have become known from official Polish sources. In the first place, Poland has committed herself, in a special agreement attached to the reparation settlement, to deliver coal to the U.S.S.R. at a special price until the end of the occupation of Germany. While the quantities to be delivered are known, there is considerable uncertainty with respect to the price. This is believed to be so low, however, that Poland would derive only slight benefit with respect to paying for corresponding imports. In the second place, Poland has concluded a series of compensation agreements with European countries which include coal commitments amounting to 12.6 million tons annually. The following table, which is based entirely on official Polish data, gives the disposition of that part of the Polish coal output shown in the preceding table as available for export:

(Millions of metric tons)

	1946	1947	1948	1949
Available for export according to Plan	14	20	28	35
Less scheduled reparation exports to U.S.S.R. 1/	6.4	11.4	13	13
	7.6	8.6	15	22
Less scheduled compensation exports 2/	12.6	12.6	12.6	12.6
Residual	-5.0	-4.0	+2.4	+9.4

1/ Originally Poland was to deliver 8 million tons in 1946, and 13 million tons in each of the years 1947 through 1950. Postponement by 3 months of the original agreement schedule has been reported. The figures for 1946 and 1947 have been adjusted correspondingly.

2/ It has been assumed (as in official Polish forecasts) that the agreements concluded in 1946 would be continued up to 1949 and be carried out as stipulated.

It will be seen from the foregoing table that Poland appears to have overcommitted herself for 1946 and 1947; the years 1948 and 1949 show a moderate surplus over and above present commitments. Since coal output in 1946 was actually 1.3 million tons higher than anticipated and deliveries of reparation coal to the U.S.S.R. were actually .6 million tons smaller,[1] the overcommitment for 1946 appears to have been 1.9 million tons less than shown in the table.

On the other hand, it is now believed by Polish experts that Polish production in 1947 will not exceed 55 million tons, 5 million tons less than the amount forecast in the Polish Plan. The Poles are known to have lowered their estimate for the coal output in 1946 from 50 million tons to 46 million tons without, however, making any adjustments for subsequent years. It is possible, therefore, that output figures for 1947 to 1949 should be lowered correspondingly. Assuming the production estimate of 55 million tons for 1947 to be correct, the overcommitment for that year would be 5 million tons greater than indicated in the table and would amount to 9 million tons.

The situation may, however, prove to be much more elastic and, therefore, less serious than the figures indicate. The Poles were in a position to negotiate with the Soviet Union a three-month postponement of the originally agreed schedule for deliveries of reparation coal and may succeed in securing further postponements. Furthermore, because of transportation and other difficulties, neither receipts nor deliveries on compensation agreements have reached the stipulated amounts, which may be regarded more as target figures than as realistic forecasts. According to official Polish data, only about 50 per cent of the total value of the agreements was carried out in 1946 and fulfillment of 70 per cent of the agreements is expected in 1947. Although the Poles have stated that this reduction in compensation trade will not affect coal exports under the barter agreements, it is reasonable to assume that these exports may fall short of the target figures to some extent. Finally, it is also possible that the Polish estimates of domestic coal consumption are somewhat exaggerated, and, in any case, it is likely that failure to attain the planned output of coal will lead to reduction in domestic consumption.

1/ Coal deliveries under the reparations settlement with the Soviet Union were reported to have been 4.8 million tons during the first 10 months of 1946. Computed on an annual basis, such coal deliveries would have been 5.8 million tons as against 6.4 million tons in the table.

Argentine Purchase of British-Owned Railways — Florence Nixon

It was announced officially on February 12, 1947, that the Argentine Institute for the Promotion of Trade and the Committee of British Railways in Argentina had reached final agreement in the railroad negotiations. The British-owned properties are to be purchased outright by the Argentine Republic for £150 million. Of this amount £135.5 million is in payment for the network of railroads and £14.5 million covers subsidiary railroad enterprises, which include real estate, port installations, bus and trucking firms, and various water and power companies. The purchase is to be retroactive to July 1, 1946, and payment will be made to Great Britain as soon as the agreement has been ratified by both governments. From July 1, 1946, to the date of payment Argentina will pay one-half per cent interest on the purchase price.

The purchase announcement came as somewhat of a surprise since, under the provisions of the United Kingdom-Argentine Economic Agreement of September 17, 1946, an Anglo-Argentine mixed-company was to be formed to purchase and operate the railroads. Only in recent weeks did the Argentines re-open discussion of an outright purchase to be financed by Argentina's war-accumulated blocked sterling balances, an idea which had played a part in the original negotiations last summer. The development is quite compatible with the Argentine Government's Five Year Plan, which contemplates the nationalization of various key industries, and is the third in a series of similar transactions which have recently procured large properties for the Republic, including some French-owned railways and the American-owned telephone system.

As has been mentioned above, Argentina plans to use her blocked sterling balances in partial payment for the railroad properties. These balances are reported by the London Economist as amounting to £125 million.1/ Whether Argentina will cover the remainder of the £150 million purchase price with exports to Great Britain or with United States dollars has not yet been disclosed.

In either case the settlement will affect Britain's rate of withdrawals from her United States credit. Britain's present financial position will be somewhat eased as demands on the available United States dollar balance of the Loan will be reduced. In addition, to the extent that Argentina wishes to rebuild her sterling holdings to some minimum level, Britain will not be required to draw down dollar balances for payment to Argentina in current transactions.

The settlement also eliminates the basis of conflict between the United Kingdom-Argentine Financial Agreement and the United States-British Loan Agreement, which recently evoked an exchange of letters between the Secretary of the Treasury and the Chancellor of the Exchequer. Since payment for the railways wipes out Argentina's blocked sterling balance, the transaction renders inoperative the clause in the United Kingdom-Argentine Financial Agreement which states that:

> "If in any year the balance of payments with the Sterling Area were unfavourable to Argentina, Argentina may furthermore dispose freely, within the said Area, of its sterling balances for an amount equivalent to the deficit."

Therefore, all future transactions obviously can only be consistent with the United States-British Loan Agreement.

1/ This figure of £125 million is £5 million lower than the amount reported on Argentine blocked account at the time of the United Kingdom-Argentine Financial Agreement in September 1946. The difference of £5 million is equal to the amount of blocked sterling which, under the provisions of Paragraph II, clause 5 of the Agreement, is to be placed at the free disposal of Argentina annually for the payment of current transactions. It seems logical to assume that this transfer has already taken place and accounts for the lower figure of £125 million on blocked account in February 1947.

Extension of Sterling Convertibility

F. Jaffy

As the result of an agreement reached last December between the United Kingdom and Canada, arrangements aimed at securing wider acceptability for sterling as a means of international payment took effect as of January 1 of this year. The arrangements provide that sterling may be used to finance the export and import trade of Canada with 22 countries 1/ which formerly had to pay in United States dollars for their Canadian purchases. Of particular interest is the fact that the United States is among the countries to which sterling may now be transferred, and that consequently sterling currently earned by Canada is convertible to United States dollars.

Perspective on the new development may be gained by recalling previous extensions of the use of sterling, particularly of its convertibility to United States dollars. At the end of the war a complicated system of sterling accounts was in existence, by which the United Kingdom divided the world into various "closed clearing areas" for sterling transfers, differentiating among them in the degree of freedom of transfer permitted. United States sterling was placed in what were known as "registered accounts". Outside sterling could not be transferred to these accounts, which could be withdrawn in the form of dollars if desired by their United States owners. Canadian sterling 2/ was placed in "authorized accounts" in London. Payments from these accounts could be made freely only within the sterling area. A group of about twelve Latin American countries comprised what was called the Central-American clearing area, and transfers of sterling were possible, again, only from these accounts to the sterling area. As a first step toward extending the convertibility of sterling to dollars, in July 1945 "United States registered accounts" and "Central-American accounts" were combined into one category known as "American accounts", among which payments and transfers could be made freely. Other arrangements extended the size of clearing areas elsewhere, among which was the February 1946 agreement with Brazil providing for the use of sterling to settle transactions between Brazil on the one hand, and the Belgian monetary area, the Dutch monetary area, the Scandinavian countries, Greece, Spain, and Turkey on the other. The next move affecting convertibility to United States dollars was the Anglo-Argentine agreement of September 1946, by which all current acquisitions of sterling by Argentina were made "freely available for current transactions anywhere."

The present arrangement in effect combines the American, Argentine, and Canadian clearing areas. 3/ The remaining countries of the twenty-two are sterling area countries from which Canada did not formerly accept sterling payment.

1/ Argentina, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Philippine Islands, Salvador, Venezuela, United States and territories and possessions, Egypt, Anglo-Egyptian Sudan, Iraq, Trans-Jordan, Iceland, Faroe Islands.

2/ Since 1942 Canada has accumulated little sterling, its export surplus to the United Kingdom having been financed first by Mutual Aid and subsequently by long-term loans.

3/ Agreement providing for transfers from American accounts to Argentina has not yet been reached but is expected shortly.

Since sterling is now transferable from Canadian to American accounts, Canadian authorized banks may now sell currently acquired sterling for United States dollars in New York. The Bank of England, as throughout the war, supports the pound by purchasing sterling in New York for dollars when the sterling rate reaches a given low. Canadian exchange control, because of the new possibility of conversion, is extended to cover sterling transactions as well as United States dollar transactions. Thus capital flight to dollars by way of sterling is guarded against.

The new agreement has been described by the Canadian Finance Minister as representing "a preliminary but important step in carrying into effect by the United Kingdom of the agreement made at the time credits were negotiated with Canada and the United States to make sterling earnings in foreign countries convertible by July 15, 1947." A formal extension of the area of sterling convertibility has clearly been made. It may be questioned, however, whether a significant increase in current dollar liabilities of the United Kingdom is involved. It is conceivable that Canada may agree to limit the amount of sterling she will convert to United States dollars. Alternatively it is quite possible that Britain will limit her dollar liability by restricting sterling transfers from sterling area countries to Canada to a given amount. It is to be remembered that sterling transfers to Canada from the sterling area remain subject either to the exchange control regulations of the United Kingdom or to local regulations designed to support British controls. The inclusion of a number of sterling area countries among the twenty-two may therefore merely signify Canadian willingness to accept sterling, in place of the United States dollars formerly required. If Britain has this intention, the relaxation of sterling control has some distance to go before meeting the requirements of the Anglo-American loan. If the volume of sterling transfers authorized between sterling area countries and Canada is no greater than the volume of United States dollars which the United Kingdom was formerly obliged to supply to these countries out of the sterling area dollar pool, the receipt of convertible currency by Canada from the sterling area will not be increased by the new measures. Substantial receipts of sterling from the non-sterling-area countries listed are unlikely both because none of these, with the exception of Argentina, accumulates sterling, and because most of them have an export rather than an import surplus with Canada.1/

To ask whether the United Kingdom's dollar liability will be increased by the new measures is also to ask whether the new measures will increase Canada's receipts of convertible currency. Governor Towers of the Bank of Canada implied a positive answer to the latter question by referring to Britain's "welcome step" in making current sterling spent in Canada convertible into United States dollars as a help in meeting Canada's U.S. dollar deficit. On the other hand, the original press report from Ottawa regarding the new regulations states "It is not expected that the new arrangement will result in any improvement in Canada's overall foreign exchange position at the present time, but it does, it is claimed, represent a considerable convenience for Canadian exporters and importers." It is of course possible that the

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1/ Out of twelve of the fourteen Latin American countries involved in the arrangement, only four had an import surplus with Canada in the first ten months of 1946, of which only those of Argentina and Panama exceeded a million Canadian dollars.

latter statement may refer to the overall volume of Canadian foreign exchange receipts, and not to the composition of these receipts. The Economist of January 11, 1947, suggests that drawings upon the United States-United Kingdom loan may be increased over the next few months as a result of the new arrangements, which "should have the effect of equalizing the rate of drawing" on the United States and Canadian credits to Britain. This supports the inference drawn from Governor Towers' statement.

It is clear, however, that no increase in Canadian receipts of United States dollars is automatically involved in the agreement in so far as its terms can be pieced together from public announcements. If Canada's increased sterling receipts are to come from sterling area countries which formerly paid Canada dollars direct, the total of sterling and dollars may be but need not be larger than before. In this connection it is possible that the United Kingdom itself, which has heretofore settled its trade deficit with Canada in Canadian dollar credits, may intend to pay, in part at least, in sterling. However, the fact that, as of the end of January 1946, only about 550 million dollars of the 1,250 million dollar Canadian loan had been used, suggests that the use of sterling is not an immediate necessity.

Equalization of Yugoslav and Albanian Currencies

R. E.

On December 27, 1946, the National Assembly of the Federative People's Republic of Yugoslavia ratified unanimously the treaty signed on November 27 between the two countries. In broad terms, the treaty is aimed at harmonizing economic plans, establishing a customs union, and equalizing the currencies of Yugoslavia and Albania.1/

The Treaty is to last thirty years with the proviso that it shall run an additional ten years unless notice is given in writing one year previous to the date of expiration. Among other measures it provides for the equalization of the two currencies within three months after the date of signing (i.e., by February 27, 1947) by putting the Albanian lek on a par with the Yugoslav dinar. In this connection it is interesting to note that the Albanian currency unit mentioned is not the franc, but a subdivision thereof, the lek. Only last July, a new Albanian decree-law was published, reestablishing the franc as the currency unit for the country,2/ and fixing its value at parity with the pre-1914 gold franc, equal to 32.67 United States cents of present value. Since the franc has five leks, this made one lek equal to 6.534 United States cents. This represented a considerable overvaluation of the Albanian currency in relation to currencies in surrounding countries and especially to the dollar.

The Yugoslav dinar has been set at 2 United States cents by the Yugoslav Government, and on the basis of one lek being equal to one dinar, the Albanian franc will now be equal to 10 United States cents. The equalization thus means a devaluation of the Albanian currency by about 70 per cent.

1/ See this Review, December 17, 1946.
2/ See this Review, August 12, 1946.

The new rate probably still overvalues the franc, but is more in keeping with the actual purchasing power of the currency in present-day Albania.

The treaty further provides that the note circulation in the People's Republic of Albania shall be in proportion to the currency circulation in Yugoslavia, due consideration being given to the number of inhabitants and the economic power of both countries. In addition, Albania agreed to introduce the price systems and the price levels existing in Yugoslavia to facilitate adoption of the currency reform. It may be suggested that adoption of the provisions of the treaty may be followed by the introduction of the Yugoslav dinar in Albania as the principal currency unit as a step toward still further integration of Albania into the Yugoslav economy.