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REVIEW OF FOREIGN DEVELOPMENTS

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Monetary Policy in Belgium

Robert A. Rennie

In Belgium, as in the United States, the primary problem of monetary reform is the desire of commercial banks to reduce their holdings of government securities in order to secure funds to expand their portfolios of private assets. The Banking Commission of Belgium has attempted to solve this difficulty by requiring all commercial banks to hold secondary reserves against all demand and short-term liabilities in the form of short-and medium-term government securities. In many respects, the decree is similar to the proposals for additional reserves outlined by the Board of Governors of the Federal Reserve System in its Annual Report for 1945.

Reserve requirements were introduced in Belgium for the first time by a decree of February 5, 1946. They vary according to the class of bank as determined by the Banking Commission.

Minimum Reserves as a Percentage of Deposit Liabilities

Class of Bank	Cash and government short- and medium-term securities a/	Cash	Capital	
			1-1-47 to 1-1-49	1-1-49 and after
Regional or specialized banks	50	6	8	10
Medium banks	60	5	5-1/2	7
Large banks	65	4	4	5

The primary cash and capital reserve requirements were designed to correct the excessive illiquidity and the insufficiency of capital among the banks resulting from the war. The core of the reform, however, is the secondary reserve requirement. It prevents the banks from generally redeeming Treasury certificates at maturity or rediscounting them at the National Bank in order to grant credits to the private economy or to purchase public bonds in the open market. In the eyes of the Belgian Banking Commission, to permit either of these alternatives would be to disperse among the commercial banks the power of monetary emission which, for reasons of economic and financial stability, must be reserved to the National Bank.

The private financial interest have objected to the secondary reserve requirement. They state that the financial policy of the Government should provide for a rapid funding of the floating debt of the State. On the other hand, the Government maintains that the wholesale liquidation of Treasury paper by the banks would produce an inflation of private credit. Fundamentally, the clash is a struggle between the Government and private business interests for control of the national credit policy. The differences in viewpoint have led to an official announcement by Prime Minister Spaak that the National Bank must be reformed to assure its complete independence of private interests and its conformity to the general policy of the Government. He added that such reform will not necessarily extend to complete nationalization of the Bank nor will the Governor become a mere functionary of the Ministry of Finance.

When the regulation became effective on March 31, 1946, the banks were permitted to reduce their holdings of Treasury issues by 2.8 billion francs, or approximately 7.6 per cent of the government short-and medium-term securities in their portfolios. In addition, during the remainder of the year, the release of deposits "temporarily blocked" under the monetary rehabilitation decrees of 1944 and 1945 permitted a freeing of Treasury

a/ The cash and government security requirements became effective on March 31, 1946. The decree was to be adaptable to changes in monetary conditions as well as to conditions peculiar to individual institutions, so that exceptions to its provisions could be made by the Banking Commission at any time. To assure flexibility in the operation of the regulations, the banks are permitted to hold cash reserves up to one-fifth of the secondary reserve requirement.

certificates immobilized by the reform.[1] These accounts were reduced by 5.1 billion francs, so that a total decline of 7.9 billions in bank holdings of government securities would have been possible had free deposits remained unchanged. However, such deposits rose from 39.5 billion to 46.0 billion francs from the end of March through December 1946. With secondary reserve requirements averaging about 60 per cent, the banks were forced to earmark Treasury certificates to an amount of 3.9 billion francs for this purpose. Therefore, there was an overall possible reduction in public security holdings of 4 billion francs. Actually, the banks curtailed their portfolios of short- and medium-term Treasury issues by 3.58 billions during the year.

Assets and Liabilities of Belgian Commercial Banks
(Millions of francs)

	Dec. 31 1939	Dec. 31 1944	Dec. 31 1945	Dec. 31 1946
Assets				
Cash	5,341	4,841	8,574	11,784
Total claims against the State	3,913	38,920	42,755	38,637
Advances to the Market	8,292	6,919	11,850	19,436
Other assets	2,483	1,652	1,996	2,390
Total	20,029	52,332	65,175	72,247
Liabilities				
Free deposits	12,685	15,774	36,638	46,019
"Temporarily unavailable" deposits	--	9,759	17,812	11,467
"Permanently blocked" deposits	--	18,405	--	--
Other liabilities	4,201	5,493	7,787	11,317
Capital & reserves	3,143	2,901	2,938	3,444
Total	20,029	52,332	65,175	72,247

The perceptible tightening of the money market caused by the decree has restored to the National Bank its control over the supply of credit. The banks began rediscounting commercial paper shortly after the regulations went into effect. Furthermore, the National Bank found that it was able to control the volume, the maturities, and the kind of commercial paper in the market through its lending, rediscount, and open market policies. These selective credit controls were directed primarily toward limiting consumer credit during 1946.

The secondary reserve requirement alone was not sufficient to prevent an excessive expansion of credit. The extension of credit to individuals and business interests increased from 12.8 billion to 19.4 billion francs,

1/ See Review of Foreign Developments, July 9 and September 24, 1945, February 25 and May 6, 1946. By the terms of the Monetary Reform decrees, accounts containing special bank notes were transformed into "temporarily unavailable" deposit accounts for which the banks received an equivalent amount of Treasury certificates with special rates of interest and terms of renewal.

or 51.6 per cent, during the year. The shortage of capital produced a significant rise in long-term interest rates, with the result that the existing rediscount rate of $1\frac{1}{2}$ per cent was not an effective curb on credit inflation. The yield on industrial and commercial bonds rose from 4.43 to 4.65 per cent during the year. To prevent the financing of investment credits by recourse to the money market, to avoid speculative operations, and to encourage importers to seek cheaper credit abroad, the rediscount rate was raised to $2\frac{1}{2}$ per cent on November 7 and to 3 per cent on December 19, 1946. These measures have tended to stabilize the credit situation in Belgium. It must be remembered, however, that the rediscount rate became effective only after the secondary reserve requirements were introduced.

The secondary reserve plan was adopted in Belgium to integrate monetary and fiscal policy. Debt management operations were combined with regulations to control the level of bank credit in order that central bank policy could be made more effective in regulating cyclical fluctuations. The plan anticipates changes in the secondary reserve requirements to reenforce the National Bank's control of credit as conditions vary. For instance, in 1947 the Government must resort to the National Bank to aid in financing a deficit of 10 billion francs. This is equal to the deficit of 1946, although substantially smaller than the 34.7 billion franc deficit in 1945. As a result, the credits to private industry must continue to be severely restricted. This policy can best be pursued by raising the secondary reserve requirements, which would create a strong market for Treasury issues and permit the National Bank to sell the securities received from the Government. The consequent decrease of the cash reserves of the banks would counteract the inflationary impact of the government deficit and prevent them from extending additional credits to industry.

The future absorption by the State of its short-term debt, made possible by budgetary surpluses in periods of restored prosperity or by consolidation in long-term bonds from savings after the re-equipment of industry has been achieved, will also permit the application of appropriate monetary policies. Over 90 per cent of the short-term government securities are held by the National Bank, the commercial banks, and the Postal Check Office. The deflationary effect of these repayments would be perfectly opportune in such circumstances, and would also require the banks to reduce their holdings of commercial paper as well as Treasury issues. The decline in deposits arising from the retirement of the government securities would tend to force them to liquidate 40 francs in commercial paper for every 100 francs reduction in deposits, since the secondary reserve establishes a reasonably constant relationship between the amount of deposit liabilities of the banks on the one hand, and their portfolios of government obligations, cash, and the total of private credits on the other.

However, if at any time it is desired to expand bank credit to private industry as a counter-deflationary measure, the secondary reserve can be lowered. This adjustment would permit the banks to sell Treasury issues to the National Bank in order to obtain additional reserves to make new loans or to buy other assets. In addition, the National Bank might also lower its present rediscount rate and provide industry with the stimulus of lower interest rates.

The secondary reserve requirements have thus restored to the National Bank a higher degree of control over the supply of credit by reviving all the traditional instruments of central bank policy--open-market operations, discount rates, and primary reserve requirements--and have thereby helped to stabilize the banking and monetary situation in Belgium.

U.S. Foreign Trade in the First Quarter of 1947.

Gretchen H. Fowler

The great expansion of United States exports for the first three months of 1947 to an unprecedented peace-time total of $3594 million, while imports for the quarter amounted to $1,412 million highlights the unbalanced character of U.S. trade. During the first quarter of 1947 the excess of exports was $2.2 billion, compared with $1.2 for the like period in 1946. All continents are currently swelling this "favorable" trade balance, whereas for the first quarter of 1946 South America and Australia experienced a favorable trade position vis-a-vis the U.S. As can be seen from the following table, the favorable balance of the United States with Europe accounted for little more than half the total export balance in the more recent quarter as compared with four-fifths for the first quarter of 1946.

U.S. Foreign Trade

Continent	January-March, 1946		Excess of	January-March, 1947		Excess of
	Exports[a]	Imports[b]	Exports	Exports[a]	Imports[b]	Exports
	(millions of dollars)					
North America	501	364	137	912	496	417
South America	236	254	-18	571	309	262
Europe	1,117	165	951	1,376	186	1,190
Asia	269	193	76	488	306	182
Australia & Oceania	33	41	-8	64	46	18
Africa	129	78	52	183	69	113
Total	2,284	1,095	1,189	3,594	1,412	2,182

Source: Department of Commerce
a/ Exports, including reexports.
b/ General imports.

Undoubtedly, rising prices have contributed greatly to the higher values of both exports and imports for 1947. The Department of Commerce index of unit values for exports (1923-25=100) rose from 100 in January 1946 to 120 in January 1947. The index of imports rose from 91 to 109 in the same period.

The 1947 annual rate of exports as indicated by the first three months of this year reached $14.4 billion, a figure well above the Department of Commerce estimates made earlier this year, while imports have not yet reached the rate of $6 billion forecast at that time. Thomas C. Blaisdell, Jr., director of the Office of International Trade, predicted on May 22 that exports of U.S. goods and servicesfor 1947 might run as high as $18 billion and imports (including services) about $8 billion.

Comparison of foreign trade statistics for the first three months of 1946 and 1947 reveals a substantial shift in the commodity composition of

U.S. exports. Immediate relief requirements, together with the relative scarcity of manufactured goods raised U.S. exports of crude materials and foodstuffs to very high levels early in 1946. In 1947, exports of semi-manufactured items have risen greatly. Not only are they more readily available this year, but the effective demand for reconstruction materials and replacements of capital equipment has grown. Almost 60 per cent of all exports fall into the "finished materials" category, although values of exports of crude materials and foodstuffs have continued to increase, partially because of rising prices, and partially because of continuing relief needs caused by the unusually harsh winter and crop failures.

The relative changes in the totals for the two periods are shown in the table below.

Exports of Domestic Merchandise
January-March

Group	Value (millions of dollars) 1946	Value (millions of dollars) 1947	Per cent of Total 1946	Per cent of Total 1947
Crude materials	297	424	13.4	12.0
Crude foodstuffs	191	210	8.6	5.9
Manufactured foodstuffs	461	406	20.8	11.5
Semi-manufactures	202	377	9.1	10.7
Finished manufactures	1,066	2,116	48.1	59.9
Total	2,216	3,532	100.0	100.0

Source: Department of Commerce

The decline in manufactured foodstuffs during the quarter in 1947 was caused by the drop in exports of meat products ($123 million) and dairy products ($59 million). Obviously, expenditures for these high-priced items have been using dollars too rapidly.

There have been no important shifts in the source of the U.S. imports during the first quarter of 1947, although Asia has increased its exports to the U.S. more rapidly than the rest of the world. The distribution of imports by classes for the 1946 and 1947 quarterly values shows that crude materials have failed to increase as much as might have been expected in view of the increasing availability of raw materials and the high level of industrial activity in the U.S. Value decreases in imports of furs ($34 million), unmanufactured wool ($18 million), and diamonds ($10 million) for the 1947 period partially offset substantial increases in crude rubber ($43 million), oilseeds ($29 million), and crude petroleum ($15 million). The values for imports during the first quarters of 1946 and 1947 are shown in the table on the next page.

Imports for Consumption
January-March

Group	Value (millions of dollars) 1946	1947	Per cent of Total 1946	1947
Crude materials	401	463	37.1	33.1
Crude foodstuffs	200	288	18.5	20.7
Manufactured foodstuffs	108	133	10.0	9.5
Semi-manufactures	195	280	18.1	20.1
Finished manufactures	176	231	16.3	16.6
Total	1,081	1,395	100.0	100.0

Although many foreign countries are faced with a lack of dollar exchange, there are no indications that the high level of exports will change, at least in the immediate future. In the long run, however, this export level cannot be maintained, for dollars are being expended at a dangerously rapid rate.

According to newspaper reports, the European Coal Organization has announced that, because of inadequate dollar resources, certain European countries are not expected to purchase the total volume of United States coal allocated to them for 1947. The International Emergency Food Council made a similar announcement as to the inability of importing countries to purchase complete allotments of meat products this year. Sugar brokers have recently announced that sugar allocated by the I.E.F.C. has not been sold, due to increased local supplies and lack of dollar exchange. Curbs on imports of consumer goods have already been established in Colombia, Ecuador, Peru, Bolivia, Chile, Brazil, Sweden, the United Kingdom, India and China, and Australia and Argentina are tightening their import controls. Thus, our "favorable" trade balance is jeopardizing the I.T.O. meetings in Geneva and our stand for unrestricted world trade.

Economic Developments in Yugoslavia   J. Herbert Furth

The blackout on economic news from Yugoslavia is lifted only on rare occasions, and even then the observer must reckon with the possibility that he is being permitted to glance not at reality but at some mirage the sight of which may confuse rather than enlighten.

Despite Yugoslavia's adherence to the Bretton Woods agreements, the country has maintained complete silence on its note circulation, banking operations, prices, wages, and international financial transactions. Taking advantage of the provisions of the agreements concerning countries occupied by the Axis powers during the war, Yugoslavia has not yet notified the International Monetary Fund of the par value of the dinar. According to a statement issued by the Bank for International Settlements, the National Bank of Yugoslavia has been amalgamated "with the other institutions of the public sector", but no amplification of this announcement seems to be available.

Public Finance

The Yugoslav legislature has passed the budget for 1947, which on paper, is completely balanced. Revenues and expenditures are estimated at 85.9 billion dinars each, of which the budget of the federal union accounts for 59.6 billion, and the budgets of the member states for the rest. The federal budget includes 27.3 billion for public enterprises, and 32.3 billion for the administration proper; of the latter sum, 13.5 billion represents military expenditures. The budget is 2-1/2 times as large as that for 1946, and expenditures for the administration of the federal union are four times as high as the comparable items of the budget for 1939. Since the purchasing power of the dinar is no more than one-third of 1939, this increase appears reasonable. It remains uncertain, however, whether revenues indeed will equal outlay, since actual figures are not being published. The actual deficit for 1946 has been estimated at nearly half of the budgeted expenditures.

In view of the decline in the purchasing power of the dinar, total budget revenues and expenditures correspond to about 28.6 billion prewar dinars or about $515 million at 1939 purchasing power.1/ This is more than half the country's estimated prewar national income. Since at present national production is at best three-fourths of prewar, public expenditures seem to equal more than two-thirds of present national income. This proportion illustrates the almost complete nationalization of the country's economy, from which only part of the agricultural sector is excepted. It also shows the burden of military expendituress, which amount to about one-ninth of the estimated present national income.

Foreign Trade

Yugoslav foreign trade statistics are still unpublished. A recent Soviet periodical, however, presents a study on the subject2/ and, while not including any absolute figures, lists several percentage ratios which may be used in combination with data from other non-Yugoslav sources.

1/ All dollar figures in this paper, unless otherwise noted, are expressed in 1939 purchasing power.

2/ Vneshnyaya Torgovlya, December 1946, p. 11.

According to that periodical, the volume of foreign trade in 1945 was around one-seventh to one-eighth of the 1939 level. Since in 1939 Yugoslav exports were 5.5 billion dinars ($99 million at the 1939 Beograd market rate) and imports 4.8 billion dinars ($86 million), exports in 1945 according to that source were thus around 750 million dinars of 1939 purchasing power ($13.5 million), and imports around 650 million dinars ($11.7 million). These figures exclude UNRRA deliveries and probably also private relief shipments. They are reasonably consistent with the U.S. data on trade with Yugoslavia. On the basis of the absolute figures given in U.S. statistics and the proportion of trade with the United States to total Yugoslav foreign trade as shown in the Soviet study, total Yugoslav exports in 1945 would be around $14 million and imports around $33 million. Deduction of private relief shipments, however, which probably accounted for substantially more than half of all Yugoslav non-UNRRA imports from the United States, would reduce the import figure to about $13 million. The results are much less consistent with the Czechoslovak data on trade with Yugoslavia. On the basis of the absolute figures given in Czechoslovak statistics (adjusted to 1939 values) and the proportion of trade with Czechoslovakia to total Yugoslav foreign trade as shown in the Soviet study, total Yugoslav exports in 1945 would equal around $24 million and imports around $18 million. In view of the nature of the statistics used, these discrepancies are not surprising.

Estimates from a U.S. source are available for the first six months of 1946, and computations are possible for the first nine months of 1946 on the basis of absolute figures given in U.S. and Czechoslovak statistics and proportions shown in the Soviet study. Moreover, the latter states that Yugoslav foreign trade increased by 60 per cent from the first quarter of 1945 to the first quarter of 1946, and by 45 per cent between January and June 1946, and that in the first six months of 1946 exports exceeded imports (excluding UNRRA and probably private relief shipments) by 23 per cent.

On the basis of the U.S. estimates, Yugoslav exports in the first six months of 1946 were 1.3 billion dinars, or around $8 million, and imports 1.05 billion dinars, or $6.5 million. These figures are consistent with the statements in the Soviet study on the increase in trade between 1945 and 1946, and on the export surplus in the first half of 1946. They are also reasonably consistent with the computation based upon the Czechoslovak foreign trade statistics, which yields an estimate for Yugoslav exports during the first nine months of 1946 equal to $15 million, and for imports, probably including relief shipments, equal to $40 million. The computation based upon the U.S. foreign trade statistics, however, would yield far higher sums, namely, Yugoslav exports during the first nine months of 1946 equal to $70 million, and imports, including private relief shipments, equal to $99 million. This trade volume would have been substantially in excess of the prewar level, which is extremely unlikely. Such a favorable development would have been widely heralded by the Yugoslav Government whereas actually the Yugoslav Minister for Foreign Trade, Nikola Petrovitch, in a speech of February 13, 1947, complained of the fall in exports and imports. It would represent an eightfold increase in trade since 1945, and thus be inconsistent with the progress report of the Soviet study, which is not likely to understate the pace of Yugoslavia's recovery. Finally, the present plight of Yugoslavia, as expressed in the appeal of the Government for help from the western countries,1/ would be utterly incomprehensible if the country, in addition to having received in 1946 UNRRA

1/ See this Review, February 11, 1947, p. 11.

help alone equal to twice its prewar imports, had had exports and commercial imports exceeding the prewar volume. The solution of the riddle may be that the proportion of trade with the United States has been shown at around one-fifth of the actual percentage in order to minimize the importance for Yugoslavia of commercial relations with the United States. This explanation is supported by the facts that the percentage shown in the Soviet study represents a startling decline in the role of the United States in Yugoslav foreign trade between 1945 and 1946, and also indicates a proportion of Yugoslav trade with the Soviet Union far greater than appears likely on the basis of U.S. estimates.

The best available estimate thus appears to be a 1946 volume of foreign trade higher than in 1945, but still only around one-fifth of 1939. Exports consisted mainly of agricultural commodities (especially fruit and fruit products), metals and ores, textile fibers and products, and chemicals. Meat products and lumber, two of the most significant items in the country's prewar exports, were absent from the list. Imports included fuel (mainly oil and hard coal), machinery and industrial raw materials, and consumer goods. The bulk of the last category of imports, however, was furnished through UNRRA. According to the Soviet study, the Soviet Union accounted for more than half of Yugoslavia's exports (mainly fruit and metals) and more than one-fourth of its imports (mainly oil, probably from Soviet-dominated Rumania, and coal, probably from Soviet-dominated Poland). Czechoslovakia and Italy were listed as the only other important trade partners. If UNRRA shipments are included, however, the United States becomes by far the most important source of supplies.

In 1947, foreign trade may be further stimulated by trade agreements recently concluded with other nations in the Soviet sphere of influence, especially Bulgaria, Czechoslovakia, Finland, Hungary, and Poland. A basic improvement in the country's international commercial situation, however, will depend upon the resumption of closer trade relations with countries outside the Soviet sphere. The Minister for Foreign Trade, in his speech mentioned above, expressed Yugoslavia's desire for such a development. So far, however, the Yugoslav Government has done little to translate these phrases into action.1/

Five-Year Plan

On April 28, 1947, the Yugoslav legislature approved the Five-Year Plan submitted by the Government. Preliminary and fragmentary information indicates that the plan proposes to raise the productivity of agriculture to 150 per cent of 1939 by investments of 19.4 billion dinars, the output of industry to 500 per cent of 1939 by investments of 90 billion, and the production of electric power to 400 per cent of 1939 by investments of 30 billion. It also includes investments in transportation and commerce of 72.5 billion, in housing and public welfare of 55.7 billion, and in other projects (forestry, handicraft, and foreign trade) of 10.7 billion. Total outlay thus would be 278.3 billion dinars, equivalent to around $1.7 billion at 1939 purchasing power.

In 1939, agriculture produced an income of around $360 million. In order to increase this income by 50 per cent, or $180 million, the plan proposes investments of $117 million. This part of the program appears to be more realistic than the rest. Yugoslav agriculture actually is capable of tremendous

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1/ A trade agreement with France was signed on May 23, 1947; no details are yet available.

improvements, including mechanization in the grain-producing plains, and a shift from grains to protective foodstuffs and introduction of modern methods of cattle breeding and horticulture in other parts of the country. Any comments, however, as to the amount of the expected rise in output, and the adequacy of the proposed investments, must await more detailed information.

The plan's core is the proposal to invest a total of $720 million in industry and electrification. In 1939, manufacturing and mining produced an output of around $162 million. The plan contemplates an increase in output by $648 million. The proposed investment, at the rate of around $1,000 per additional worker, would give employment opportunities for an additional 720,000 industrial workers, as compared to a total of 450,000 industrial workers before the war. The yearly output per worker in 1939 was around $360; if the same output were reached by the new workers, the increase in industrial production would be around $260 million. In order to reach the output projected in the plan, however, productivity per worker (old and new) would have to be almost doubled.

The plan to increase the number of industrial workers by 720,000 within five years, or 144,000 per year, may not be unattainable; it corresponds closely to proposals made by non-Yugoslav observers.1/ The contemplated increase in productivity per worker, however, is extremely improbable. At present, productivity per worker in Europe is substantially lower than before the war, due to physical deterioration of the labor force and to the disturbances caused by the war and its aftermath. In Yugoslavia, these factors were supplemented by the extermination of the prewar entrepreneur classes and of the ethnic minorities (Jews under Nazi occupation, Germans after liberation) that used to supply the country with a very large part of its managerial talent. Moreover, the new industrial workers will have to be recruited mainly from the excess agricultural population and lack the skill of the prewar labor force. Under such circumstances, it can hardly be expected that the introduction of new capital would raise the productivity per worker within five years from about 75 per cent to about 195 per cent of prewar. It would probably be more realistic to assume in that period at most a gradual increase to the prewar average.

Investment in transportation and commerce of around $440 million certainly would substantially improve the country's system of communications, and expenditures of around $335 million for housing and public welfare also should not encounter lack of investment opportunities. It is questionable, however, whether the country's manpower, after having yielded 144,000 people annually for the increase in industrial labor, would suffice to provide workers for such projects, which in themselves would contribute little to increasing national production. The proposed investment of around $64 million in other fields is so indefinite as to defy comment.

Even granting the possibility of utilizing new capital of around $340 million annually for a period of five years, the question remains how that capital could be obtained. It is hard to envisage a rate of domestic savings higher than about 8 per cent of the prewar national income, which gave the great mass of the population a bare subsistence minimum, and about 30 per

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1/ See Yugoslavia, Economic and Financial Developments (June 1946), p. 34.

cent of the prospective increases in national income.1/ Assuming that the prewar national income of slightly less than $1 billion will be reached again by the end of 1947, and that the proposed investments result in an annual rise in the national income by $100 million,2/ domestic savings could increase from $80 million in the first year to $200 million in the fifth year, yielding a total of $700 million, or 40 per cent of the required capital. The remainder of about $1 billion at 1939 purchasing power, or about $1.5 billion at 1947 purchasing power, would have to be furnished by foreign grants or credits.3/

The Yugoslav Government can hardly expect to find abroad sources of funds sufficient for such plans. It would be well-advised, therefore, to restrict its projects to the fields of agriculture and of those industries in which the country has natural advantages (food processing, lumber, paper, artificial fibers, chemicals, non-ferrous metals). Such investments would be less spectacular than the establishment of heavy industries and the building of railroads,4/ but they would require more modest funds, which the Government might be able to procure, especially if it abandons the policy of alienating those countries that alone can provide the capital for the economic development of Yugoslavia.

1/ In view of the totalitarian character of the Yugoslav Government, these rates already have been set at twice the proportion prevailing in a comparable free economy; see op. cit., p. 36.

2/ This extremely optimistic assumption contemplates an annual increase in agricultural production by $36 million, conforming to the Government plan, a rise in industrial output by $52 million, corresponding to an increase in the industrial labor force by 144,000 workers without any decline in productivity per worker, and smaller increases in the output of forestry, handicraft, and commerce. The total increase would represent an annual gross yield of 30 per cent of the newly invested capital.

3/ In order to be independent of foreign assistance, the Government would have to compel the population to save annually 14 per cent of the prewar national income plus 100 per cent of all increases. Such a policy, however, would defeat itself by lowering labor morale and efficiency. Moreover, in order to obtain such savings rates, the Government probably would have to cut down unproductive expenditures, especially for the army and the political police, and this might endanger the stability of its totalitarian regime. Since a large part of the country's postwar rehabilitation was financed by UNRRA help, the domestic economy--including the Government--so far has been burdened but little by problems of raising capital.

4/ It is reported that the well-advertised "youth railroad", built in 1946, has not been able to start operations because of construction faults.

Swiss Foreign Economic Policy

A. O. Hirschman

General Economic Conditions

During recent years the Swiss economy has given a brilliant performance in economic isolation. Surrounded by countries whose economic life has been disrupted by physical destruction and inflation, and almost entirely cut off from essential foreign supplies in 1944/45 during the period of fighting in Western Europe, Switzerland has succeeded in keeping its economy both prosperous and remarkably stable. In spite of various raw material and labor shortages, industrial production has increased with respect to prewar. Swiss industry has had to satisfy a strong demand, both at home and abroad, and its highly developed mechanical, electrical, and chemical branches were able to replace a number of products traditionally supplied by Germany.

The total labor force has been increased by 250,000 persons, or by 14 per cent, since 1938. Considerable expansion in industrial capacity has taken place, mainly since the end of the war. An increase of over one-third with respect to prewar in the production of electric power more than compensated for sharply reduced coal imports. Both imports and exports slightly exceeded the 1938 volume in 1946. As no production indexes are available, indexes of industrial employment are given in the following table to indicate industrial progress.

Indexes of Industrial Employment
(1938 = 100)

Industries	1945	1946
Construction	89	108
Cotton	77	87
Silk	115	123
Metal	122	137
Watch	117	131
Chemical	130	159
Food-processing	104	120
Total employment	117	129

Source: Monthly Bulletin of the Swiss National Bank

Crop production, which had been considerably expanded during the war at the expense of livestock, receded only slightly during the two postwar years. In spite of Switzerland's great wartime effort, city-dwellers remain dependent on foreign supplies of bread grains for about three-fourths of their consumption. Extension of agricultural production is at present hampered by the shortage of labor which is no longer relieved by the wartime compulsory farm labor service. On the whole, however, the wartime increase of domestic production and the recovery of food imports, which in 1946 fell short by only 13 per cent of the 1938 volume, rendered possible a satisfactory level of consumption by the Swiss population. It has been shown that, with respect to rationed products, average prewar consumption was in general less than the present rations which alone permitted an average daily intake of 1,650 calories.[1]

1/ Etudes et Conjuncture (Economie Mondiale), February 1947, p. 18, and Statistical Yearbook, 1945, pp. 372-373.

Many important food products as well as shoes and clothing are free from rationing and can be obtained at prices within the reach of the average consumer.

That Switzerland has been enjoying not only a prosperous but at the same time a comparatively stable economy appears evident from the following table:

Money Supply, Prices, and Wages in Switzerland

End of	Currency circulation (Millions of Swiss francs)	Commercial banks' sight deposits	Wholesale prices	Cost of living	Hourly wages
1939	2,050	2,573	108[a]	103[b]	100[b]
1944	3,548	3,205	206	152	170
1945	3,835	3,618	199	151	183
1946	4,090	3,926	203	155	201
March 1947	3,932	n.a.	205	155	n.a.

a/ Based on August 1939 = 100.
b/ Based on January/August 1939 average = 100.
n.a. = not available.

Source: Statistical Yearbook, and Monthly Bulletin of the Swiss National Bank.

The comparatively moderate expansion of the money supply was due to wartime budget deficits and to the monetization of the balance-of-payments surplus. The rise in prices and wages was slightly greater while the cost of living lagged behind as a consequence of an efficient and generally observed system of rationing, price control, and subsidies. The resulting increase in real wages explains the previously noted improvement in the level of consumption. During the two postwar years, when many wartime controls were gradually lifted, both wholesale prices and cost of living remained stable and only wages continued to rise.

International Economic Position

The reader of Swiss economic publications and of official or semi-official statements on the state of the Swiss economy could hardly suspect the existence of such reassuring statistical series as have just been reproduced. These publications and statements have been consistently pessimistic and often alarmist; they have emphasized the dangers of "over-employment" and of inflationary explosions. The Swiss international economic position was generally designated as the main origin of these dangers.

In view of the primary importance thus attached to Swiss international transactions and of the otherwise plentiful statistical information available, it is both surprising and unfortunate that no balance-of-payments estimates have been published. The only available data, which are summarized in the following table, concern merchandise trade, gold movements, and foreign lending which has taken place through the mechanism of clearing and payments agreements.

Elements of Swiss Balance of Payments, 1940-46
(In millions of francs)

	Payments				Receipts		
	Imports	Gold purchases[a/]	Foreign credits	Total	Exports	Other[b/]	Total
1940	1,854				1,316		
1941	2,024				1,463		
1942	2,049	4,096	1,300[c/]	14,236	1,572	7,124	14,236
1943	1,727				1,629		
1944	1,186				1,132		
1945	1,225	941			1,473		
1946	3,423	680	359[d/]	6,628	2,676	2,479	6,628

a/ Increases in holdings of Swiss National Bank and of Treasury plus estimated domestic sales of gold officially stated to have amounted to over one billion Swiss francs since 1941, of which 300 million in 1946; it has been estimated that 150 million out of the one billion were sold in 1945.

b/ Residual item.

c/ Clearing credits accumulated during the war, mainly with Germany and Italy.

d/ Net foreign lending since V-E Day (see below, p. 19).

This table reveals the great importance of the net invisible receipts on current and on capital account which must have been accruing to Switzerland's credit. With the exception of 1945, its trade balance has been passive and if it has consistently accumulated gold and has been able to extend credits this is due to the tourist trade, to income from foreign investments, to receipt of remittances (important in wartime because of the inflow of refugees and the international relief organizations located in Switzerland), and because of the constant inflow of refugee capital from surrounding countries.

Foreign Economic Policy

If no measures had been taken by the Swiss monetary authorities, the average inflationary impact due to the inflow of gold and foreign lending would have been more than a billion francs a year, a substantial injection for a country the national income of which was estimated in 1939 at 8.3 billion francs. In comparison, the budget deficit exceeded the billion franc mark only during 1944 and 1945 and disappeared entirely in 1946. Thus it is true that the principal and continuing danger to the stability of the Swiss economy originated in its balance of international payments.[1/] The Swiss foreign economic policy has been dominated by the awareness of these dangers and has

1/ It would be very important for a correct appraisal of the inflationary forces at work to know the breakdown of the "Other Receipts" between current account and capital account receipts.

expressed itself in a great variety of attacks upon them. It may be conveniently analyzed under four main headings: (1) Export policy, (2) Gold policy, (3) Exchange rate and dollar policy, (4) Foreign lending policy.

(1) Export Policy

(a) Partial Blocking of Export Proceeds. This method was applied in 1944 to half of the dollar proceeds of Swiss watch exports and was extended in 1945 to all other exports to the United States; it was discontinued on January 1, 1946. The period for which the proceeds were blocked was set at three years. The exporter was free to obtain an advance from his bank but in this way monetization took place through the commercial banks rather than through the Central Bank and at the same time the exporter's cost was increased through the discount retained by the banks. Blocked export proceeds amounted to 463 million francs at the end of 1946.

(b) Direct Quantitative Restriction of Exports. This more effective method came to the fore mainly in the course of 1946 when trade under payments agreements became unbalanced or when credits granted were being exhausted faster than had been contemplated. Quantitative restriction of exports is in most cases more than the simple establishment of an export quota: export licenses are required for every transaction and their allocation proceeds through the familiar device of reference to base periods.

(2) Gold Policy

(a) Domestic Sale of Gold. As part of its fight against inflation, the Swiss Government has sold important quantities of gold coins to the public through the intermediary of the commercial banks. On November 1, 1946, the requirement that banks must submit the name of the buyer was abolished, and as a consequence the Swiss black market in gold coins collapsed. Export of gold remained subject to license, but smuggling produced a substantial slump in black market gold quotations in neighboring countries. Total domestic sales since 1941 totalled over one billion francs, of which 300 million occurred in 1946 alone.

(b) Sterilization. This policy, familiar from the 'thirties, consists in Treasury gold purchases from the Central Bank intended to prevent the gold inflow from expanding the money supply; to finance its purchases the Treasury issues bills, thus offsetting the initial monetization of the gold by the Central Bank. It should be noted that even if all the bills were subscribed by the public rather than by the banks, complete offsetting in an economically meaningful sense most likely would not be obtained; for the reduction of spending resulting from the Treasury borrowings is likely to be far smaller than the increase in spending due to the conversion of the net export proceeds, remittances, etc., into francs.

Large-scale sterilization of gold took place mainly in 1944 and 1945 when the Federal Government took over from the National Bank all gold that accrued from non-commercial receipts of dollars. In 1946 the National Bank again converted dollars accruing from authorized non-commercial transactions, but the Government slowly increased its gold holdings as a consequence of negotiated gold transfers from Great Britain, Sweden, and other countries.

Total "sterilized" gold holdings of the Swiss Treasury amounted to 776 million francs at the end of 1946; of these 387 million were held in New York, 297 million in London, 63 million in Canada, and 27 million in Berne as a result of a transfer from Sweden.

(c) General Attitude Toward Gold. In general, it has been the policy of the Swiss monetary authorities to ask for payment in goods rather than in gold. A typical example of the Swiss reluctance to accept gold was given by the agreement with Sweden in October 1946. In this agreement which was made necessary through the disturbances which had arisen as a consequence of the revaluation of the krona, Switzerland finally agreed to accept gold in excess of 10 million francs per month only on the bizarre condition that Sweden sell gold at a reduced price calculated to make that country bear half the interest cost incurred by the Swiss Treasury through sterilization.

Switzerland's determination not to be helplessly exposed to internal inflation caused by an inflow of gold has been largely responsible for its unwillingness to join the International Monetary Fund, which stipulates, in the section on scarce currencies, that "The Fund may, if it deems such action appropriate to replenish its holdings of any member's currency, ... require the member to sell its currency to the Fund for gold." (Article VII, Section 2 ii).1/

(3) Exchange Rate and Dollar Policy

When Canada and Sweden appreciated their currencies in 1946, the expectation that Switzerland would follow suit was widespread. As a matter of fact, it would have seemed almost more natural for Switzerland to carry out an appreciation than for the other two countries, since there already existed in Switzerland a "free" dollar market where the Swiss franc was traded at a considerable premium with respect to its official parity of 4.28 francs to the dollar. Trading through the Swiss National Bank at the official rate, also called the "commercial" rate, is prerequisite for all importing from the United States and the benefits of the rate are granted to exporters as well as to dollar conversions consequent upon certain specified non-commercial transactions, such as family remittances, tourists' expenditures within certain limits,2/ and investment income for specified years.3/ All other owners of dollars or dollar assets wishing to obtain francs cannot go to the National Bank, but have to buy francs at the "finance dollar" rate which has fluctuated between 3.20 and 3.70 during the past year. This discount of the finance dollar, however, does not imply an undervaluation of the franc at its official rate, but reflects the fact that the finance dollars cannot be used for importing goods from the United States. Could they be so used, the finance dollar rate would soon merge into the commercial dollar.

1/ Cf. also Valentin F. Wagner, "Die Schweiz und Bretton Woods", Aussenwirtschaft, December 1946, p. 154.

2/ The limit for tourists' expenditures was raised in May from $125 to $200 per tourist per week.

3/ 1945, 1946, and current income, according to regulations issued by the Swiss National Bank in May. This transferability of income from investments in the United States is probably calculated to lessen the repatriation of Swiss assets which were unfrozen in November 1946 and which, in accordance with the agreement then reached, are now slowly being certified by the Swiss authorities if exempt from ex-enemy control.

Thorough discussion of the problem of currency appreciation in the Swiss economic and financial press has pointed out that the Swiss franc is, if anything, overvalued with respect to the dollar if a prewar year is taken as the base; that the present prosperity of the export industry is probably transitory; and that the problem of Swiss monetary policy derives to a great extent from capital movements which it is impractical and unwise to check through exchange rate manipulations. The ills for which appreciation was proposed as a cure actually were more susceptible to treatment by the present policies: quantitative restrictions on exports, on gold inflow, on convertibility of dollars into francs, and on foreign lending. The recent difficulties of Sweden and Canada have strengthened the Swiss authorities in their determination to keep the exchange rate stable.

While the limitation on convertibility of dollars into francs makes the existence of a subsidiary market with its own exchange rate unavoidable, it has recently been the aim of the Swiss monetary authorities to narrow the differential between the two markets. The selling of gold bars by the National Bank to private persons was recently discontinued because it had led, especially after the cessation of gold sales by the Bank of Mexico, to a considerable demand from foreign buyers who obtained the required Swiss francs by dumping finance dollars on the market. The finance dollar rate rose immediately upon this decision and has already been pushed further toward the official rate by the recently increased allotment of officially convertible dollars to American tourists and to Swiss earners of dollar incomes.

These changes in Swiss monetary policy have been ascribed to a change in the directorate of the Swiss National Bank. But they are even more easily explained by changes in the economic outlook. During recent months, exports have shown a tendency to level off and imports have continued to increase. During the first 3-1/2 months of 1947, the gold holdings of the Swiss Bank and the Federal Treasury have remained steady at 6.2 billion francs. For once, Switzerland thus seems to share in the economic developments of other European countries, with the difference that what in other countries has become disquieting dollar shortages reflects itself in Switzerland in slightly less aversion toward the dollar.

(4) Foreign Lending Policy

The amount which Switzerland lent through clearing advances to Italy and Germany during the war was largely the result of political expediency. Economic and, to some extent, humanitarian considerations were prevalent in the pattern of Switzerland's postwar lending. This difference may help to explain why Switzerland lent Germany and Italy during the war almost four times as much as it has contributed so far to European reconstruction.

The following table shows Switzerland's postwar lending activities:

Swiss Credits, V-E Day to December 31, 1946
(In millions of Swiss francs)

	Commit-ment	Utili-zation	Increase in foreign Swiss franc holdings	Net utili-zation
Belgium	40	27	37	-10
France	300	276	46	230
United Kingdom (sterling area)	260	174	33	141
Netherlands	75	38	16	22
Total[a]	675	515	132	383
Minus: Net decrease in Swiss credits with clearing countries, May 1945/Dec. 1946				24
Net postwar disbursements				359

a/ In addition there were unutilized credits of 5 million francs to Norway and of 10 million to Czechoslovakia.

Source: Bundesblatt, Feb. 27, 1947, p. 801; Bulletin of the Swiss National Bank.

It may be noted that the terms of trade have moved in Switzerland's favor. In 1946, export prices had risen 2.53 times above the 1938 level, and import prices only 2.34 times. Had Swiss 1946 imports been bought at prices representing no improvement in the terms of trade, an additional 280 million francs would have become available to other countries--an amount probably exceeding Swiss net foreign lending during the year.

Again, of course, the explanation for the surprisingly small foreign lending is in great part Switzerland's preoccupation with "over-employment" and domestic inflationary dangers resulting from exports not offset by imports. Furthermore, an important factor limiting Switzerland's capacity to lend has been the redirection of its trade toward rich countries which did not request any credit. Switzerland is the only country in Europe that has succeeded in expanding its exports to the United States to the same extent as its imports. Had not 17 per cent of Swiss exports gone to the United States in 1946 as against 7 per cent in 1938, a larger share of production for export might have been set aside for wartorn European neighbors. Switzerland's net lending to its European trading partners has also been hampered by its partly successful attempts to obtain repayment of prewar and wartime clearing credits.

Another factor was an internal postwar investment boom caused by the housing shortage, deferred maintenance, and the survival of a wartime tax intended to discourage the distribution of corporation profits. Therefore, it would have been really quite difficult for Switzerland to lend more substantially than it did. In 1946, most Swiss industries had orders on hand for over two years and putting large sums of Swiss francs at the disposal of foreign buyers would have merely resulted in bidding up prices and wages of the export industries, unless Switzerland was prepared to enforce new and rigid controls over internal investment, consumption, and the direction of foreign trade.

There is one way, however, through which Switzerland could actively contribute to the reconstruction of Europe without increasing domestic inflationary pressures: by lending to other countries some of its gold and dollar resources to be used for purchases outside Switzerland. This seemingly paradoxical variety of the tied loan concept is behind several projects which have been mentioned recently as being in the discussion stage:

(1) Conversations have been reported between the French and the Swiss, as a result of which France might obtain on credit the substantial dollar assets (estimated at $300 million) which French citizens hold in Swiss banks, and which were also unblocked along with genuine Swiss dollar assets in November 1946. A preliminary for such a transaction would be an amnesty for French citizens who evaded the French exchange control, followed by a conversion of their dollar holdings back into Swiss francs.

(2) It has been reported that the Netherlands has been trying to induce the Swiss to buy first-quality Dutch industrial shares up to 100 million francs against Swiss-owned gold.

(3) Swiss bankers have negotiated with the Danish Government a loan of $10 million to be used for repayment of arrears of Danish dollar debt amortization.

(4) Finally, the first project of this kind has become reality during the past week. It is a loan of 50 million francs to the Belgian Telegraph and Telephone System guaranteed by the Belgian Government. It is understood that the francs obtained are to be converted into dollars in the finance dollar market for the eventual purchase of equipment in the United States. The loan will bear interest at 4 per cent and is repayable in 12 years.

These ingenious combinations, which could be termed "third-market loans",1/ might, however, very well be prevented from assuming significant proportions by the latest economic developments. The first signs of buyers' resistance to Swiss exports are reported in the press and the inflow of gold during 1946 is now said to have been due primarily to advance cash payments for Swiss exports and delayed payments by Swiss buyers for imports from abroad. Should the postwar trend of "over-employment" and export boom be reversed, the lending of gold and dollar reserves for purchases elsewhere would soon encounter the opposition of the monetary authorities. On the other hand, the situation does not seem likely to deteriorate to such an extent that Switzerland will want to extend credits to bolster its export industries. For these reasons, there seems but little hope for a substantially increased contribution by Switzerland to European reconstruction. The main contribution will continue to be Switzerland's role as an important link of world trade, the stability of its economy, and the impressive, if somewhat ungenerous, wisdom with which it handles its affairs.

1/ This expression was suggested by A. B. Hersey.