L.5.2.
CONFIDENTIAL

RFD. 101

Board of Governors of the Federal Reserve System
Division of Research and Statistics
International Sections

REVIEW OF FOREIGN DEVELOPMENTS

November 30, 1948

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

THE 1948-49 ECA PROGRAM AND RECOVERY OF U.S. EXPORTS

Samuel I. Katz

According to an Economist summary of the Paris report of the organization of European Economic Cooperation (OEEC) on the "First Year of ERP", the dollar deficit of ECA-Europe for the fiscal year 1948-49 is estimated at $4,578 million. 1/ American aid allocations will meet $4,359 million of the current deficit and the remaining $219 million will be drawn from existing gold and exchange reserves. The 1948-49 deficit is some $2,863 million below the 1947 deficit of $7,441 million for these countries. Preliminary review of the OEEC data reveals that the estimates which they include for trade between Europe and the United States are consistent with recent trends in American exports to, and imports from, ECA-Europe. On this basis, the volume of exports during 1948-49 are expected to fall below the 1947-48 total. Even to achieve this expected annual volume, monthly exports in the December-June period will have to rise

1/ Excluded from this total are data on Portugal, Switzerland, Bizonia, Trieste, and Netherlands overseas territories. See Records and Statistics, Supplement to the Economist, October 23, 1948, pp. 373-376 and October 30, pp. 402-404.

substantially above the low July to November rate. 1/

The balance of payments of ECA-Europe with countries to which gold and dollar payments must be made, for 1948-49 with comparative figures for 1947, is estimated in Table I. Practically 90 per cent of the expected 1948-49 reduction of $2,863 million is due to reduced dollar payments for imports. ECA-Europe's direct dollar imports are to be cut $1,700 million, accounting for 59.5 per cent of the reduced dollar deficit. The remainder is found in the sharp cut in "Other transactions" which includes the net dollar trade of oversea territories. The curtailment of Europe's direct dollar imports reflects in part improved European harvests and higher production of such important goods as coal, steel, and timber. The extent of the shift away from dollar imports is suggested by comparing the reduction of $1,700 million in dollar imports with the expected increase of $5,000 million in total OEEC imports from member countries and from the rest of the world. The improvement in the "other transactions" position is largely explained by reduced dollar drawings of non-OEEC countries within the sterling area.

TABLE I

ECA Countries: Dollar and Gold Current Balance of Payments, Calendar Year 1947 and Fiscal Year Ending June 30, 1949
(In Millions of Dollars)

	Calendar 1947	Fiscal 1948-49	Improvement in 1948-49	Percent of Total Improvement
1. Trade balance:				
a. Imports	6,877	5,177	1,700	59.5
b. Exports	1,279	1,470	190	6.5
c. Balance	-5,598	-3,708	1,890	66.
2. Invisible balance	- 630	- 546	84	3.
3. Current balance	-6,228	-4,254	1,974	69.
4. Other transactions	-1,213	- 324	889	31.
5. Total current deficit	7,441	-4,578	2,863	100.

European countries are expected to be much more successful in reducing dollar imports than in expanding dollar exports. Dollar-exports are expected to increase about $200 million above 1947, but higher prices probably account for a large portion of this rise. The increase is unimpressive when compared with the expected expansion in total OEEC exports to all countries from $9,300 million in 1947 to $15,800 million in 1948-49.

1/ An earlier article on U.S. exports in the first half of 1948 appeared in this Review, October 19, 1948, pp. 11 ff.

To what extent is the OEEC program for 1948-49 likely to be realized? That the estimates, in the words of the Economist, "bear about them the mark of solid realism" is apparent from a cursory examination of the summary data available. But projection for eight months (since four months of the 1948-49 fiscal year are passed) involves a high degree of uncertainty, even under favorable conditions.

This note will examine those parts of the OEEC report for which recent United States statistics are available, in an attempt to assess the validity of the estimates and to consider the impact of the 1948-49 program upon current trends in American trade. In summary, the examination reveals that the estimates are not inconsistent with recent trends in American export and import trade with ECA-Europe. Perhaps more important, the data imply the unlikelihood of any substantial rise in American exports, during the remainder of the 1948-49 fiscal year, growing out of accelerated Marshall Plan shipments. It would appear, in fact, that American exports to the world during this fiscal year may not rise appreciably above the quarterly rate of $3,300 million registered for the first six months of 1948.

Referring to Table I, the estimated OEEC-country invisible balance for 1948-49 is estimated at a deficit of $546 million or a quarterly average of $137 million. The figures include dollar invisibles with Canada and perhaps other Western Hemisphere countries but the United States should account for practically the entire deficit. The OEEC estimate is consistent with U.S. data on the invisible balance between the U.S. and the ECA countries, shown in Table II. The quarterly deficit of $137 million is, as would be expected, some $20 million below the high quarterly average for 1947 and $5 million above the 1946 deficit. Perhaps the most impressive fact revealed in Table II is the substantial changes in Europe's invisibles account with the United States since the war, compared with the 1938 position.

TABLE II

United States: Invisibles Balance with the ECA Countries,
Quarterly Averages, 1938, 1946, 1947,
And First Quarter 1948
(In Millions of Dollars)

	1938	1946	1947	1948
U.S. Receipts:				
Investment Income	25	27	40	60
Transportation	29	185	266	165
Travel	5	8	14	13
Miscellaneous Services	16	96	69	85
Total Receipts	75	316	389	323

(Continued)

U.S. Payments:				
Investment Income	33	37	41	42
Transportation	58	70	92	89
Travel	18	14	24	16
Miscellaneous Services a/	15	64	75	98
Total Payments	124	185	232	245
Net Balance	-49	+132	+157	+78

Source: Unpublished data of the Department of Commerce.

a/ Excludes expenditures by occupation forces in occupied areas.

On the commodity side, ECA-Europe expects to export to the United States some $760 million out of $2,189 million to all Western Hemisphere countries The estimate for exports to the United States is directly comparable with American import statistics since United States import data are on an f.o.b. basis. By reference to Table III, it will be seen that the OEEC figure not only is consistent with post-war United States imports but might be considered somewhat on the low side. Certainly, the OEEC quarterly average of $190 million, being slightly below American imports for the first three quarters of 1948, is a cautious estimate.

TABLE III

United States: Imports from ECA-Europe (excluding Switzerland), quarterly, 1946 to 1948

(In Millions of Dollars)

1946 quarterly average	145.1
1947 quarterly average	153.3
1948, by quarters:	
I	207.4
II	199.7
III	200.6

Direct comparison of ECA-Europe's imports from the United States with American export statistics raises the question of whether the import figures are based on f.o.b. or c.i.f. American export values. It is probable that the import value is on an f.o.b. basis, since freight charges are included in the invisibles account. Even if the import figure were c.i.f., adjustment to eliminate the transport charges would only slightly reduce the figure for United States exports to ECA-Europe. Use of the original OEEC estimate would, in that case, slightly overstate United States exports.

There is, however, a more likely source of overstatement. Included in the summary table of OEEC imports from the United States is a figure of $651

million for oil and products. In previous reports, the OEEC nations have included as imports from the United States, oil and products for which dollar payment is required. By this criterion, some Middle East and Caribbean oil has been shown as if they were imports from this country. Since the United States oil represents nearly 50 per cent of total OEEC oil imports, it is likely that the current figure also includes oil from dollar sources which will not be American exports. In this note, the full dollar import figure will be used since at this stage there is no accurate basis on which non-United States oil can be subtracted from the total. It is highly probable, therefore, that the value of OEEC imports from the United States used below will overstate, rather than understate, the amount of prospective American exports.

The OEEC report estimates Europe's imports from the United States at $4,438 million for the current fiscal year or a quarterly average of $1,110 million. 1/ Thus, United States exports to Europe for 1948-49 are expected to run at about the rate recorded for the first half of 1948, as is shown by the data in column 1, Table IV below. To the extent that the estimates are overstated, United States shipments to ECA-Europe would fall below the rate for the first half of 1948.

TABLE IV

United States: Exports to ECA-Europe (excluding Switzerland), Rest of World and Total, Quarterly, 1946 To Date
(In Millions of Dollars)

	(1) ECA-Europe	(2) Rest of World	(3) Total	Percent (2) of (3)
1946 quarterly average	792	1,643	2,435	67.5
1947 quarterly average	1,269	2,568	3,837	66.9
1948, by quarters:				
I	1,093	2,225	3,318	67.1
II	1,025	2,214	3,239	68.4
III				

Assuming, then, that United States exports to Europe continue at, or slightly below, the rate for the first half of 1948, total shipments to all countries would not be expected to exceed the quarterly average of $3,280 million recorded for the same six-month period. Under these conditions, United States

1/ If the OEEC figures were on a c.i.f. basis, the adjusted (f.o.b.) figure would be about $3,932 million for the year, or a quarterly average of $983 million. Excluding all oil and products but not adjusting to an f.o.b. basis the annual figure is $3,787 million and the quarterly estimate $947 million.

exports would amount to not over $13,100 million for the fiscal year, compared with $13,936 million for the 1947-48 fiscal year. But the conditions under which this estimate is made may in some respects prove to be too favorable. Not only is the ECA-Europe figure probably overstated but there are no reasons to expect, on balance, any big increase in shipments to the rest of the world. Exchange-saving measures of the sterling area which are anticipated in the British 1948-49 payments estimates ought to curtail shipments to several important markets. The recent import controls introduced by South Africa should bring down the total for the African Continent. Prospects for Latin America and Asia are uncertain but, speaking generally, there is little ground for the expectation that any increase in this trade - should these exports actually expand - would more than offset the declines expected for other areas.

Dollars available for financing exports (adjusted for errors and omissions) for fiscal 1948-49 were estimated in the October 19 issue of this Review (page 2) at between $17,500 million and $18,000 million. Deducting invisibles and unrecorded goods shipments, dollar availability for recorded goods exports becomes a residual ranging between $13,100 million and $13,600 million. 1/ Estimates of American exports based on the OEEC import program for the current year, therefore, appear to be reasonably consistent with earlier estimates based on dollar availability.

If exports are actually to reach $13,100 million, then the 1948-49 year's total will be about $800 million below the 1947-48 volume. Actual exports were $1,022 million in July, $988 million in August and $927 million in September. To achieve the $13,100 million total, the average monthly rate for the remaining 9 months would slightly exceed $1,100 million monthly or a rate about equal to that for the first half of 1948. Since October and November exports are certain to run well below the $1,100 million figure because of the shipping strike, the average for the 7 months, December to June, will have to expand substantially. The likelihood of such an increase is further confirmed by the President's letter of November 26 to the ECA to push Marshall Plan aid as fast as possible and to use the full amount of currently appropriated funds in 12 months ending April 1, 1949 instead of 15 months. Exports are therefore expected to rise above recent low levels and above the higher rate of January-June 1948, but the year's total should run below the rates which had been expected in the earlier days of the ECA program. Actual exports for the year, however, are likely to be affected by factors which cannot yet be included in these calculations, such as additional American economic or military aid to Europe and/or other areas.

1/ Total U.S. receipts for exports of invisibles and unrecorded goods totalled $4,400 million in 1947; for the first half of 1948 the annual rate was $4,300 million.

PAR VALUE OF THE MEXICAN PESO

Gerald Alter

Mexico has been without an effective par value since July 23, 1948, when it had to suspend the sale of dollars at the rate of 4.85 pesos per dollar. The Mexican government, while at present supporting the peso at about 6.90 pesos per dollar, has indicated its unwillingness to establish a new official note of exchange until the peso's behavior in the free market has been studied and the Bank of Mexico's international reserves replenished. Mexican authorities hope for a seasonal upturn in exchange receipts around the end of 1948, but considerable uncertainty surrounds Mexico's balance of payments prospects. It can be inferred, in view of the tone of President Aleman's September Message to Congress1/ that the Mexican authorities also wish to see how far anti-inflationary measures can be pushed before setting a new par value.

Determination of a New Par Value

Exchange transactions are not subjected to scrutiny in Mexico and capital outflows are unregulated. Since July, when the 4.85 parity was suspended, there is evidence of capital outflow, and speculative factors may also be affecting imports and exports. The Bank of Mexico has been losing reserves in attempting to support the market, but in view of the presence of speculative factors, it may be dangerous to rely on the behavior of the market in deciding whether the currently effective rate of 6.90 is appropriate. The absence of an official parity may be contributing to the weakness of the peso.

Determination of the appropriate rate is obscured, however, by inadequate information relating to Mexico's international transactions. It is known that Mexico used its gold and foreign exchange reserves and drew upon the International Monetary Fund and the U. S. Stabilization Fund to the extent of about $140 million in 1947 and about $47 million in the first half of 1948. In view, however, of a recorded fall in imports in the first half of 1948 and a consequent reduction in Mexico's deficit on trade account, it is difficult to understand the magnitude of the reserve loss which occurred in the first half of 1948.

Redress of the disequilibrium in Mexico's international accounts, it is estimated, would involve a reduction of imports of 150-200 million dollars below the 1947 level. A reduction of $200 million below the 1947 level, or $100 million below the annual rate prevailing in the first half of 1948, would permit presumably a modest accumulation of reserves. The question thus is what rate of exchange can produce a reduction in imports of about 17 percent below the level prevailing in the first half of 1948.

The present rate represents a devaluation of about 40 percent expressed in terms of the increased peso cost of acquiring foreign exchange. With such a devaluation, a price elasticity of demand for imports of about -.43 would produce

1/ See this Review for November 2, 1948, pp. 1 to 6.

the required decline in imports, assuming that the quantitative controls over imports were not weakened. If quantitative controls were removed, the required elasticity might be as much as -.70. These calculations, furthermore, are valid only on the assumption that domestic prices, wages, and incomes are held in check.

We have investigated the possibility of determining historically the price elasticity of demand for imports in Mexico by correlating changes in the volume of Mexico's imports during the period 1929-1939 with changes in import prices, after taking account of changes in money income. Our preliminary studies showed that for several reasons this type of analysis cannot be applied to the Mexican case. First, we were unable to obtain a sufficiently reliable index of Mexican import prices. The Mexican Government has no such index for this period, and the Department of Commerce index of export prices, which with some modification might be used, suffers from several defects which cannot be corrected with our available resources. 1/ It is particularly difficult to allow for changes in tariff duties, which were extensive in Mexico during this period. Second, with manufactured goods playing such an important role in Mexican imports, volume indices can only be constructed by deflating value indices. Thus, the absence of a good price index makes it impossible to construct a reliable volume index. Third, the official Mexican national income series for the period is considered to be unreliable, although as a general index of changes in money income during the period, it may be sufficiently accurate. Fourth, changes in the structure of the Mexican economy since the 30's are significant and a technique for correcting for these changes has not been developed.

More informal techniques must therefore be relied upon for determining whether an increase in import prices of apparently 40 percent will produce the necessary reduction in imports, assuming that measures to halt inflation are imposed.

It may be illuminating to evaluate the Mexican situation with regard to exchange rate changes and imports in the late 1930's. The decline in imports which occurred in 1938-39 is generally attributed at least in part to the exchange devaluation which was effected. Between 1937 and 1938 imports declined in volume by about 30 percent, while the peso cost of dollars rose about 25 percent as the result of exchange devaluation. Since the dollar price of imports also fell, however, the peso price of imports increased by less than 25 percent--about 17 percent. Despite further devaluation after 1938, imports rose by over 10 percent between 1938 and 1940.

1/ Particularly serious is the fact that the Commerce index employs a variable weighting system, so that changes in the product composition of exports show up as changes in unit values. Despite the decline in prices which occurred at home between 1937 and 1938, the Commerce Indices which show changes in unit values of manufactured and semi-manufactured goods increased between 1937 and 1938.

The precipitious decline in imports between 1937 and 1938 may be interpreted to support the view that the volume of imports in Mexico was quite sensitive to changes in import prices, and thus to exchange rates. However, the degree of sensitivity is certainly overstated by the 1937-38 comparison made above. The primary reason is that concurrently with exchange depreciation upward revisions in tariffs were made; thus the actual peso price of imports increased more than 17 percent. After 1938 the rise in imports, despite continued devaluation, was probably due to the increase in domestic prices and incomes which occurred.

In view of the experience of the late 30's, and despite the difficulty encountered in isolating the effect of exchange devaluation on imports, it appears that a 40 percent exchange depreciation, when supplemented with other measures, should produce significant reductions in imports. It should be recalled, that just as the '38-'39 devaluation was preceded and accompanied by upward tariff revisions so was the present '48 devaluation preceded by a drastic upward revision in tariffs. The effect of tariff revisions made in 1947 may be expected to produce additional reductions in imports, as domestic substitutes for some items are developed. Also, quantitative import controls, which were not extensively employed in 1938-39 are now being used on a wide scale.

Although changes in the Mexican economy since 1937 have been substantial, there is no evidence that the structure of consumer-goods imports has changed in a manner which would reduce sensitivity to price increases. Some commodities which have increased in relative importance, such as foodstuffs, are probably relatively insensitive to price increases, and their importation will in any case be subsidized according to present indications. On the other hand, the importation of other commodities, such as durable consumer goods, which have also increased in importance, appear to be quite sensitive to price increases.

The general economic situation, however, which is quite different today from that of the late 30's, may create a real problem in reducing imports. Imports of machinery, commercial vehicles, tractors, locomotives, construction materials and other goods going into capital formation declined materially during the '38-'39 devaluation. The decline of such imports particularly was probably induced, however, more by deflationary pressures than by import price increases. Producer demand in Mexico was probably more seriously affected by the United States recession occurring in 1937-38 than was consumer demand, which was sustained by the maintenance of money incomes. 1/ Imports of capital goods and construction materials

1/ The maintenance of money income in 1938, despite a slight reduction in the peso value of exports and a greater reduction in the volume of exports, appear to have been due in part to governmental deficits.

constituted about 40 percent of total imports in 1947, and the high level of economic activity prevailing today may make it very difficult to reduce such imports through the price mechanism only. A judicious use of quantitative import controls to limit the magnitude of capital-goods imports may therefore be necessary.

Maintenance of a New Par Value

Failure of the Mexican authorities to establish a new par value can be attributed in part to their fears that it will be difficult to maintain an official exchange rate in the face of persistent inflationary pressures. As is the case in many other countries where economic development programs are pushing ahead, economic policies capable of reconciling the objective of economic development with the objective of economic stability are difficult to devise and perhaps even more difficult to execute.

A well-conceived program in Mexico must have as its objectives: (1) to maintain a high level of demand for Mexico's production of goods and services at roughly the current level of prices, (2) to prevent any further increase in such demand at roughly the present level of domestic prices, while permitting the realization of first-priority development objectives, (3) to reduce, and maintain the reduction in, the demand for imports, so long as Mexico is unable to secure a higher level of exchange receipts without diverting productive resources to exports Some further domestic price increases may be necessary, particularly if prices abroad rise. Also, allowance should be made for increased demand sufficient to absorb whatever increases in production are anticipated.

The formulation of a program capable of attaining these objectives is greatly hampered in Mexico, as elsewhere in Latin America, by inadequate information concerning the level and composition of private investment, consumer expenditures, and other components of the gross national product.

Nevertheless, it is clear that inflationary pressures are going to continue in Mexico at least so long as the U. S. economy continues on a high level of activity. In fact, insofar as Mexico's international economic relations are concerned, new sources of inflation are being encountered. During recent years Mexico has enjoyed the benefits--deflation wise--of a substantial balance of payments deficit on current account. In 1947 this deficit on current account amounted to over a billion pesos. Mexico is no longer in a position to sustain such a deficit in its current account and, in fact, must begin to accumulate reserves. Mexico may have a surplus on current account of over 1 billion pesos in 1949 if exchange depreciation and related measures are effective in reducing imports. During the first half of 1948 Mexico had already greatly reduced its deficit on current account.

Irrespective of whether a par value is to be declared or not, it must be recognized that the change from a deficit position to a surplus position in Mexico's current balance of payments has inflationary implications, which, though not overwhelming in magnitude, must be forthrightly faced.

Our estimates indicate that the devaluation to an exchange rate of 6.90 will add in its initial impact at least 400 million pesos to the national income, an increase of about 2 percent of the 1947 level. This estimate takes into account the effect of devaluation and related measures on imports and exports, as well as other items in the balance of payments on current account, and makes a very generous allowance for the deflationary effect of the 15 percent tax imposed on exports.

Although economic stability and the maintenance of a new par value requir stable prices on domestic production, there must be price increases on imports arising directly from a higher peso cost of dollars. These price increases are the mechanism by which the devaluation which has occurred will reduce the volume of imports. If measures are taken to prevent a continuation of other sources of inflation, notably government fiscal operations and private investment, the devaluation which has occurred should not produce overpowering inflationary pressures.

A reduction of imports by about 100 million dollars below the level prevailing in the first half of 1948 should not in itself jeopardize economic stability. Imports in 1947 were equivalent to 17 percent of Mexico's national income. However, over 40 percent of Mexico's imports in 1947 were capital goods. Increases in the price of capital goods may not have any immediate effect on the internal price level. Imports other than capital goods constitute about 10 percent of the national income. A 40 percent increase in the price of these other imports would increase over-all prices by less than 4 percent.

In the most important component of consumer outlay, consumption of foodstuffs, imports constitute a very small part. According to a study made by the FAO, imports constituted less than 5 percent of Mexican food consumption in 1947. Assuming that imported food prices increase by the full 40 percent, devaluation would increase over-all food prices by no more than 2 percent. With the increased peso cost of imports of lard and wheat absorbed by subsidies, food prices should increase by little more than 1 percent.

Although recent information is not available on the relative importance of imported raw materials in the various industries, the 1940 census indicates that, with the exception of the metal working industries, chemical industries, and paper, imported raw materials constitute less than 15 percent of the gross value of production. The weighted average for all industries is about 11 percent. It can be assumed that since 1940 dependence of Mexican manufacturing industries on foreign raw materials has not increased. Thus, prices charged by Mexican manufacturing enterprises should be increased by no more than 2 percent as a result of the increased peso costs of imported raw materials.

More serious perhaps in its implications is the potential inflationary effect of the increased peso price of exports on domestic supplies. After taking account of the export tax, Mexican producers will enjoy peso prices about 20 percent higher than before the depreciation. Assuming as we do for purpose of this analysis that domestic costs do not rise in the first instance, the higher export price will obviously increase the incentive of producers to divert their production to export markets. However, if the Mexican authorities continue their

present policy of restricting the export of goods essential for domestic consumption, domestic supplies should not be materially reduced by diversion to export markets.

Thus, even though the exchange devaluation will increase money incomes and the prices of imported merchandise, the situation is by no means beyond control. Major sources of inflationary pressure are private construction and other private investment, and government deficits.

The Bank of Mexico has estimated that construction, both residential and business, constituted over 40 percent of gross private investment in the period 1940-1945. The volume of construction in the Federal District more than doubled between 1939 and 1945, and the value of construction almost quintupled. Over 65 percent of the value of construction completed in the Federal District in 1945 was residential, including apartment houses as well as private homes. Construction activity in the Federal District apparently fell somewhat in 1947 and early 1948, and data on building permits issued in recent months show a consistent decline in planned construction. The Mexican Government should examine this situation carefully to determine whether private construction activity might be curtailed even further. Should it be determined that construction activity can be reduced, measures permitting a discriminating treatment with respect to various types of construction should be considered. Such selectivity would be desirable both from economic and political points of view.

The extent to which private construction activity need be curtailed is dependent on the success which can be anticipated in the government effort to reduce its planned expenditures. During recent years, there has been a great expansion in Government expenditures on highways, railroads, electrical projects, and irrigation and port facilities, which actively compete with private construction for men and materials. Ministries have been requested to project expenditures for 1949 at 10 percent less than the 1948 rate, but in view of the magnitude of increased expenditures in recent years for highways and irrigation, it may be questioned whether such reductions are sufficient. In any case, however, it is necessary that the Mexican Government appraise the total construction field, both private and public, to determine the necessary reductions in each.

With respect to private investment other than construction, establishment of over-all limits is very important from the point of view of controlling direct demand for imports, as well as controlling domestic inflation. Capital goods constitute a very important part of total imports. It is in this field particularly that balance of payments equilibrium and economic development programs meet in a head-on collision. It can be questioned whether capital-goods imports should be subjected only to the test of the market. Just as Mexico employs quantitative restrictions to limit luxury consumer-goods, it may be wise to consider some priority schedule on capital goods in times of crisis.

More effective enforcement of the income tax and the imposition of higher rates, particularly on upper income groups, would be highly desirable.

Such measures would reduce and possibly eliminate the over-all inflationary impact of governmental operations without exercising direct upward pressure on prices by increasing costs. Income tax collections in Mexico have been very low in relation to national income and did not increase in recent years relative to incomes to the extent that a progressive tax system requires. As shown in the following table, income tax receipts constituted only 2.4 percent of the national income in 1947.

	Income tax receipts (millions of pesos) 1	National Income* (millions of pesos) 2	Percent 1 ÷ 2
1945	296	16,000	1.9
1946	371	19,200	1.9
1947	486	20,300	2.4

* Provisional estimates of Bank of Mexico.

In Argentina we estimate that income tax receipts constituted 6 percent of the national income in 1947, and relative to income have increased more since the end of the war than has been the case in Mexico.

In addition to reducing the over-all inflationary impact of government operations, higher income tax collections from upper income groups would withdraw purchasing power from those who purchase a large part of luxury imports and travel extensively abroad. Such taxes would thus contribute directly to reducing payments abroad. Also, such a taxation program would permit the government to take a firmer position in opposing wage increases.

THE SHELL CARIBBEAN PETROLEUM COMPANY FINANCING — Elizabeth B. Sette

Public announcement was made on October 18 that the Shell Caribbean Petroleum Company, a subsidiary of Royal Dutch-Shell, had sold 250 million dollars of 4 per cent bonds maturing in 20 years. This issue, like most large issues of industrial concerns in recent months, was sold privately to institutional investors, including eight insurance companies in the United States and one in Canada, and the Carnegie Corporation; it was priced at par. Little information is yet available on the issue, which is said to be the largest financial operation ever undertaken by an industrial corporation, 1/ for the company has published very few details about the financing.

The funds will be used "for oil development in the western hemisphere", presumably mainly in Venezuela. If the funds are to be expended primarily for

1/ The largest corporate issue on record is one for 340 million dollars, which was offered by the American Telephone and Telegraph Company late in 1946.

western hemisphere materials and labor, borrowing in New York rather than in London or Amsterdam was clearly necessary. "Oil development" would include exploration, increased production from existing fields, and expansion of marketing facilities. One financial publication, however, indicates that a portion of the funds will also be used to acquire securities of the Shell subsidiary that handles operations in Canada.

Financing Arrangement and Terms

Several features of the Shell Caribbean loan appear to be substantially different from those underlying the financial arrangements made by most oil companies.

In the first place the amount involved was so large that public sale of the issue would have been difficult. In cases involving such large sums, insurance company purchases on a large scale are a prerequisite to a successful public sale. But if this offering had been public, insurance companies might have refrained from buying the issue on the grounds that they would not have had sufficient time to investigate the rather novel and complex arrangements.

Security for this loan is provided not only by the value of the company's property in Venezuela (which includes proven oil reserves of 400 million barrels), but also by the specific pledge of some 8.8 million shares of common stock of the Shell Union Oil Corporation of the United States. The market value of the pledged shares since the beginning of 1946 has ranged from 216 to 410 million dollars, and in mid-October was about 350 million, or 40 per cent more than the amount of the loan. Although this alone could hardly be considered adequate collateral for a 20-year loan, the fact that it represents assets in the United States gives the lenders an important added safeguard against any events that might cause the company's main assets (located outside the United States) to be unavailable. It may also be noted that this Shell Union stock represents probably the largest single dollar asset belonging to nationals of ERP countries, and the pledging of the stock for this loan may represent an important step in the utilization of such assets in furthering European recovery.

The rate of interest on the loan is 4 per cent, which is higher than on recent large loans to petroleum concerns in the United States. There have been no closely comparable loans with which comparisons of terms can be made. Most loans to oil companies in the past two years have been to domestic concerns engaged in both producing and refining operations. Only three of the domestic concerns that have borrowed privately during the past two years are engaged to any considerable extent in oil producing. In December 1947, the Union Oil Company of California borrowed $15 million for 25 years at 2.80 per cent. In April 1948, Standard Oil of Ohio borrowed $35 million for 20 years at 3 per cent, and the Gulf Oil Company borrowed $84 million for 25 years, also at 3

per cent. 1/

Reasons for the Higher Interest Rate

Several factors inherent in the Shell Caribbean borrowing arrangement account in part at least for the higher interest rate charged. The large amount of the issue and the character of the collateral have already been noted. In addition, the company's operations will be primarily abroad and will, therefore, be subject to possible unfavorable effects of foreign legislation involving such matters as excess profits taxation or even the expropriation of facilities. Finally, the company may sell oil abroad as well as to United States concerns; in the event that sales to the latter were insufficient to cover payments on the loan, there would be some danger from exchange risks.

1/ It should be noted that interest rates became somewhat firmer during this period.