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THE BALANCE OF PAYMENTS APPROACH IN THE EUROPEAN RECOVERY PROGRAM

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In presenting the European Recovery Program to the Congress, the Administration has adopted the so-called "balance of payments approach" to the problems of assessing the need of European countries for external aid and of establishing the form (grants or loans) which such aid should take. This approach to the assessment of need has been attacked from various quarters, while a number of people (including the Harriman and Herter Committees) have been inclined to rely upon rule-of-thumb commodity tests for determining whether aid should be extended on a grant or loan basis.

Balance of Payments Approach to Assessment of Need

The Paris Report and the Administration's analysis thereof have established the fundamental nature of the malady which afflicts the economies of most European countries--namely, that during a transitional recovery period, their productive capacity will be insufficient to maintain consumption at a tolerable level while at the same time providing the investment goods necessary to assure their recovery. More specifically their production capacity has been judged to be insufficient even though it is postulated:

1. That the countries concerned will use their best efforts to maximize their own production and to direct it toward meeting their essential needs;

2. That the intended levels of consumption (standard of living) will be no higher than required to avoid social unrest and to offer adequate incentives to the working population; and

3. That the investment programs will be appropriately designed to increase productivity and to restore the economies to a self-supporting basis by the end of the recovery period.

The objectives of the European Recovery Program in any of these countries can be attained, therefore, only if the gap between its volume of production on the one hand, and its aggregate consumption and investment requirements on the other, is filled by means of external supplies. Detailed analysis of the balance of payments of these countries has been merely an instrument for refining and making more specific the conclusions drawn from these economic aggregates, and has proceeded on the same basic assumptions.

It must be recognized that production may be devoted to meeting essential needs not only directly, but also indirectly through the international exchange of goods. Naturally, to the extent that a country devotes production to export, it must import more to cover its essential domestic needs. But exports ordinarily yield means of payment for imports, so that the import surplus (balance of payments deficit) is not thereby increased. In fact, production for export normally involves making more efficient use of productive resources than if they had been used exclusively to meet domestic requirements; thus it increases the real value of production, and usually reduces the gap in the country's economy for which external financing is required.

Detailed analysis of the country's foreign trade prospects may also indicate necessary changes in its economic program arising from non-availability of desired imports or non-marketability of potential exports. Following these adjustments, a picture is developed of its import requirements and export possibilities in goods and services. In addition, account must be taken of other necessary payments, such as contractual service on external debts. The end result is an estimate of the country's balance of payments prospects, showing the deficit which requires external financing.

It should be clearly understood that prospective estimates of a country's balance of payments are more in the nature of programs than of forecasts. They are programs which can materialize only if means are in fact found to finance the deficits. To the extent that such means are not found, imports must decline toward the level of exports, which will in turn decline for lack of imported materials or because of the pressure to divert potential exports to the meeting of unsatisfied domestic needs. The country's international payments will then balance at a level which fails in greater or lesser degree to provide the import requirements essential to the accomplishment of the domestic recovery plan.

In the European Recovery Program, therefore, the United States must feel concern for the solution of the entire balance of payments problem of the participating countries. It by no means follows, however, that this solution is the unique responsibility of the United States.

In the first place, the great bulk of each country's consumption and investment requirements will be met from domestic production, and each country is pledged to maximize production in general and production for export in particular. With respect to the financing of such "hard-core" deficit as may remain in its balance of payments, each country must seek reasonable assistance from the following sources before a case is established for direct U.S. Government aid:

1. Use of its external resources (gold, foreign exchange, foreign investments, etc.). Upon analysis, however, it has been shown that only limited contributions can or should be expected from this source.

2. Credits from the private capital market in the United States, directly or through the International Bank. However, in view of the risks involved in most cases, major assistance cannot be expected from this source.

3. Credits from other participating countries, especially for financing trade deficits with such countries. In general intra-European deficits are expected to be handled in this manner, subject to limited U.S. aid in the form of "off-shore purchases" in surplus countries on behalf of deficit countries in cases where an undue financing burden would otherwise be thrust upon a particular surplus country in intra-European trade. It should be recognized that such special aid to the debtor countries would necessitate no increase in U.S. aid to the participating countries as a group, as long as the accretion of dollars to the creditor country is taken into account through a corresponding cut in that country's own allotment of direct U.S. aid.

4. Credits from non-participating countries outside the Western Hemisphere. It is such credits (plus liquidation of external resources, especially investments in the countries concerned) which are relied upon to finance deficits of participating countries with this area. The program makes no allowance for U.S. aid in the meeting of these deficits, except to a limited degree in the case of Bizonal Germany.

5. Credits from Western Hemisphere countries outside the United States. Such credits (again together with liquidation of investments, etc.) are expected to finance some part of the participating countries' deficit with the area in question, but the amount is limited by the fact that Canada and most of the important Latin American countries rely heavily upon their surpluses with Europe to obtain dollars for meeting their essential requirements in the United States.

A great variety of resources, domestic and external, are therefore to be brought to bear in meeting the material requirements of participating countries before supplementary assistance from the United States is invoked. As a matter of fact, the proposed figure of U.S. aid during the first fifteen months of the European Recovery Program (including Department of the Army appropriations for Bizonal Germany) amounts to only 25 per cent of the gross merchandise import requirements of the participating European countries (including imports from each other), and probably to less than 5 per cent of their estimated consumption and investment requirements.

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Opposed to this general "balance of payments approach" is the so-called "commodity approach", the advocates of which would restrict U.S. aid to the financing of particular commodity requirements of participating countries, and preferably to requirements which could be met from U.S. "surpluses".

It should be granted at the outset that such a formula, even if confined to U.S. exports, is not unworkable in the case of those participating countries whose uncovered deficit in their general balance of payments does not exceed the amount of their imports from the United States. In such cases, the provision of an appropriate amount of U.S. exports in the form of U.S. aid would leave the countries concerned with sufficient resources to cover their remaining import requirements. But how is this "appropriate amount" to be determined unless by the application of some sort of a "means test" measuring their need for U.S. financing, meaning, of course, reversion to the general balance of payments approach? If this were not done, and some rule-of-thumb commodity approach were followed, some participating countries might well be allotted more U.S. aid than they required.

A more serious difficulty arises in the case of those participating countries which would still have an uncovered balance of payments deficit even if they received all U.S. exports on aid terms and took full advantage of other sources of financing available to them. In such cases, the failure of the United States to extend its aid to the financing of "off-shore purchases" would necessitate cuts in their import programs, which by definition would jeopardize the success of their whole recovery effort. Again, the allocation of "off-shore purchases" to specific commodities may prove quite feasible, but only if the selection of commodities to be so financed is guided by the principle that for any recipient country enough commodities must be included to meet the otherwise uncovered deficit in its general balance of payments.

As a final observation on the "commodity approach" to assessment of need, it is worth pointing out that the allocation of U.S. aid to any particular commodity or commodities is in practice quite arbitrary and artificial. If a country's net uncovered deficit in its balance of payments amounts to, say, 10 per cent of its import program, the financing of <u>any 10 per cent</u> of its imports ordinarily will provide an adequate solution to its problem. It can usually pay for the remaining 90 per cent, whatever its commodity composition, out of other resources. U.S. aid should not be defended on the ground that it enables a country to carry out some particular segment of its import program, but rather on the ground that, as a supplement to other resources, it makes possible the whole import program and the associated domestic program for economic recovery.

Balance of Payments Approach to Determination of Aid Terms

After a country's need for a certain amount of U.S. aid has been established by analysis of its balance of payments position and its access to other sources of financing, the question then arises of whether the aid should take the form of a grant or a loan, and in the latter case, of what rate of service (interest and amortization) should be required. The Administration has proposed that decisions on such questions should be guided by the basic criterion of the prospective capacity of the recipient country to repay, and judgments on this matter must depend primarily upon the prospects for the balance of payments of the country concerned.

Again a "commodity approach" to these questions has been suggested in various quarters. Specifically it has been proposed that aid be extended as a grant to the extent that it consists of food, fuel, and fertilizer; as a short- or medium-term loan to the extent that it consists of raw materials; and on a long-term loan basis if it takes the form of long-life capital equipment. It is argued that food, fuel, and fertilizer are "unproductive" goods; that raw materials can be paid for within a short time because they can be processed into exports; and that long-life capital equipment can produce over a period of years the goods required to effect repayment.

It is true that different types of imported commodities may contribute in different degrees to the repayment capacity of the recipient country, although the particular classification suggested is subject to a number of important technical criticisms. (For example, food and fuel for a capital-goods producing country like the United Kingdom may be just as "productive" as capital equipment for a country like Greece. And why should the investment of fertilizer in the soil be regarded as less "productive" than the application of farm machinery?) More importantly, however, the fact that the provision of certain imported goods makes a relatively large contribution to a country's repayment capacity by no means demonstrates that the country can be judged capable of repayment for those goods. Such a judgment must take into account other factors in the country's balance of payments and in its international financial position which far surpass in importance the contribution to repayment capacity made by the particular imports financed by the aid program. Some of the participating European countries have such inadequate exporting capacity that they may find repayment of aid an unmanageable burden even though the aid is used to acquire capital equipment that would contribute directly and significantly to redressing their balance of payments deficits. On the other hand, other European countries, even though unable to pay cash, might be readily able in the course of time to repay a loan which was used to buy food or other consumption goods, even assuming that such imported goods made no contribution to their repayment capacity.

But there is an even more fatal weakness in the "commodity approach" to this problem, which arises out of a failure to recognize the point made above, namely, that allocation of U.S. aid to particular commodity imports of a participating country is necessarily an arbitrary action taken as a matter of convenience. U.S. aid to any recipient country will cover only part of its import program, the remainder being financed from other resources (proceeds of exports, liquidation of external resources, credits from other sources, etc.). What possible guidance does the "commodity approach" offer as to which imports should be covered by U.S. aid and which from other resources? Yet this decision is crucial. If the proposed "commodity approach" were adopted, each recipient country would naturally ask U.S. aid so far as possible for covering its imports of commodities eligible for grants. Especially if broad authority is obtained for off-shore purchases, many countries could thereby obtain all U.S. aid in the form of grants, even though they were quite capable of repaying part or all of the aid received. At the other extreme, countries incapable of any repayment but having uncovered deficits in excess of their imports of "grant" commodities would have to take some U.S. aid in the form of "loan" commodities for which eventual repayment would be required.

Nonetheless, the "commodity approach" does have a kernel of validity since there are distinct advantages, from the point of view of popular psychology, in having loans finance the flow of certain commodities and in having grants finance others. For example, if a loan is used to finance long-life capital equipment which remains physically in existence as a testimonial to U.S. aid, the public in the recipient country may be psychologically more prepared to accept the sacrifice of the contractual payments on the loan, when due, than if the goods financed under the loan had been immediately consumed. On the other hand, there are definite advantages in allocating grants to such commodities as food, fuel, and fertilizer. There is no doubt that the idea of grants would be more readily accepted by the public in the United States, as a humanitarian measure, if the grants were linked with goods of this type. At the same time, the people in the recipient country would presumably be more aware of and more responsive to U.S. generosity if they could be assured that it was goods entering into their daily lives which were being supplied on a grant basis.

Hence in adopting the "capacity to pay" criterion, care should be taken to retain so far as possible the political-psychological advantages of the "commodity approach". All countries applying for U.S. aid will naturally arrange their programs so far as possible in such a way as to present "grant" commodities for financing by the United States. To the extent that the United States decides to extend grants rather than loans, this arrangement of their programs will be satisfactory. If, however, the United States decides to request repayment, it would be distinctly preferable from the point of view of the United States to have the programs rearranged so that the specific commodities to be financed by the United States will consist so far as possible of "loan" commodities, preferably long-life capital equipment. (The same is true if the applicant's credit status is good enough to justify referral of the request to the International Bank.) The net result would be that so far as possible grants would be linked to "grant" commodities and loans to "loan" commodities.

CHANGES IN TURKEY'S INTERNATIONAL ECONOMY J. Herbert Furth

Turkey, Portugal, and Switzerland form the small group of countries that are not supposed to need foreign aid, but on the contrary are expected to contribute actively to the rehabilitation of the other European nations within the framework of the European Recovery Program.

In the case of Turkey, this assumption is based upon the strength of the country's international financial position.1/ Turkey not only escaped all war damage, but in view of its possession of strategic materials (chrome, textile fibers, and foodstuffs) was able during the war to drive exceedingly advantageous bargains both with the Axis and the Allied powers. Moreover, Turkey repaid virtually all its prewar foreign debt in devalued French currency and received substantial new credits, primarily from the United Kingdom, on very favorable terms, as well as a modest amount of lend-lease aid from the United States. The country thus was in a position to expand its foreign trade substantially during the period following the end of hostilities, when all its competitors were suffering from the disruption of production by the war and from lack of foreign exchange. In September 1946, it adjusted the foreign exchange value of its currency to the wartime changes in price level and currency circulation, and thereby eliminated the principal remaining obstacle to the normalization of its international economic relations.

There are many indications of Turkey's sound position. Its gold and foreign exchange reserves were equivalent to $230 million at the end of November 1947. Its foreign trade has shown an export surplus in every year since 1930 (with the exception of an insignificant import surplus in 1938). Note circulation, price level, and the free-market foreign exchange value of the currency have suffered little change since the end of the war.

During the last six months, however, this serene picture has been marred by unforeseen changes in the country's foreign trade balance. In the eight months from October 1946 (the first month after devaluation) through May 1947, Turkey had total exports of 611 million Turkish liras ($218 million at the official rate of 2.80 liras per dollar) and imports of 322 million liras ($114 million), leaving an export surplus of 289 million liras ($104 million). In the five months from June through October 1947, however, Turkish exports fell to 161 million liras ($57 million) while imports reached 325 million liras ($116 million), leaving an import surplus of 164 million liras ($59 million). Thus a monthly export surplus of $13 million has turned suddenly into a monthly excess of imports of almost $12 million.

In part, the decline in exports during the second half of the calendar year reflects a seasonal pattern: in normal years Turkish exports are particularly heavy in spring, when the tobacco crop is marketed, which frequently accounts for as much as one-third of all Turkish exports. In 1946, this regular pattern was distorted by the devaluation, which had been anticipated by many traders and therefore had caused exporters to withhold shipments until after September. For this reason, exports were contraseasonally high during the winter months.

1/ See this Review, April 22, 1947, p. 11.

Another and, in the long run, more important reason for the emergence of an import surplus is the steady growth in the value and volume of imports. In some measure, this development might be interpreted as an effect of the foreign trade multiplier: increased exports, by raising the national income, also raised the demand for imports. On an annual basis, the export surplus in the first four months of 1947 probably was as much as 5 per cent of the national income. Conforming to the time lag between changes in income and imports, the rise in imports continued when the rise in exports already had come to an end. This movement was encouraged by the increased availabilities of foreign products the supply of which had stopped during the war, and the improvement in the maritime shipping situation. The Turkish foreign trade authorities apparently were either unwilling or unable to counteract these tendencies by stricter application of import regulations.

Contrary to the experience of the United Kingdom, the import surplus was not caused by an adverse change in the terms of trade. The main Turkish exports (tobacco, cereals, livestock, dried fruit, nuts, hides, metals, valonia, and textile fibers) have risen in price as much or more than the average of all products, while some of the most significant imports (machinery and industrial consumer goods) have risen far less. Thus, on the average for 1946, the domestic wholesale price index (1938 = 100) stood at 427, the export price index at 383, and the import price index at 265; in May 1947 (last date available) the domestic wholesale price index had remained at 427, while the export price index had risen to 529 and the import price index only to 395.

The significance of the import surplus for Turkey's international financial position depends largely upon the question of how far Turkey had used the export surplus of the preceding months for increasing its foreign exchange reserves. Declared reserves had not increased so much as the foreign trade figures would suggest. In the five months from October 1946 through February 1947, Turkey had an export surplus of 237 million liras, but increased its gold and foreign exchange reserves by only 117 million. In the three months from March through May 1947, Turkey had an export surplus of 51 million liras, but its gold and foreign exchange reserves dropped by 42 million. A sum of 213 million Turkish liras ($77 million) thus has been used for purposes other than the accumulation of declared reserves. Of that sum, only the fate of around 30 million liras is known: gold to that amount was sold by the Turkish Government to the population in order to avoid unfavorable repercussions of the devaluation of September 1946. Another 30 million liras in gold was indeed used to pay the Turkish contribution to the Bretton Woods institutions, but it is not known definitely whether or not that sum is carried by the Central Bank as part of its foreign exchange reserves. Even if this is not the case, an amount of 153 million liras would remain unexplained.

International payments on non-trade account cannot have filled that gap since such payments are insignificant and about balanced by receipts on non-trade account. The Government may have imported military supplies not shown in its foreign trade statistics, but in the period under consideration the Government was in a position to purchase the bulk of such supplies by means of the credits and grants made available for that purpose by the United States.

Neither can unrecorded changes in the trade balance with clearing countries account for the difference since the Central Bank carries clearing balances among its assets and liabilities in foreign exchange. Moreover, these balances have remained insignificant throughout the period under consideration: at the end of November 1947, Turkey had an overall net debit balance of 11 million liras, as compared to one of 12 million at the beginning of the year.

There is some indication, however, that at least part of the unexplained sum may have been used to build up hidden reserves, either public or private: in the five months from June through October 1947, the import surplus amounted to 164 million liras, but foreign exchange holdings dropped by only 101 million, and hidden reserves may have been used to pay for the difference. If hidden reserves included the bulk of the amount not otherwise accounted for, they were not exhausted by these payments, and the international financial position of Turkey would be stronger than indicated by its official statistics.

Another development of the last months has been the gradual substitution of sterling for gold. On March 1, 1947, when Turkish gold and foreign exchange reserves had reached their peak, gold holdings amounted to 668 million liras and net foreign exchange holdings (assets minus liabilities) to 114 million. By the end of November 1947, gold reserves had decreased by 188 million to 480 million while net foreign exchange holdings (mainly sterling) had risen by 51 million to 165 million. This development resulted from a kind of currency speculation: the Turkish authorities believed in the spring of 1947 that sterling would be permanently convertible into dollars after July 15, and therefore encouraged Turkish merchants to export for sterling and import for dollars since, on the basis of the official exchange rates, sterling prices tended to be higher than dollar prices. When the convertibility of sterling was ended in August 1947, the authorities had to reverse their position drastically. In September, the Turkish Ministry of Commerce stopped all licenses for export against sterling, and relaxed this ban only slightly in November, pending negotiations between Turkey and the United Kingdom on the disposition of the country's sterling balances. This measure could curtail exports to the sterling area but could not increase exports to the dollar area which Turkish traders apparently had neglected somewhat during the preceding months. The sterling problem is particularly serious for Turkey since sterling was used in payment for Turkish exports not only by the United Kingdom but also by Greece, Egypt, the Arab States, and, in part, by Italy. It has been estimated that about 43 per cent of Turkish exports went to sterling countries during the first seven months of 1947.

The prospects for the Turkish international trade position will depend mainly on two factors. The first is Turkey's ability to sell the bulk of its tobacco crop for dollars at satisfactory prices; this, in turn, depends largely upon the production and price situation in competing countries, especially Greece and Bulgaria. The second is the possibility of using sterling proceeds of exports directly or indirectly (through conversion into dollars) in payment for necessary imports. Apart from these price and convertibility problems, the maintenance of the 1946-47 volume of exports should not be difficult. In May 1947 (latest date available) the export volume stood at 104 per cent of 1938, the interwar year in which Turkish foreign trade was largest. In view of the wartime expansion of the country's system of production, however, such a slight increase does not appear excessive. Imports, on the other hand, reached in May 1947 a volume of 122 per cent of 1938, and such a volume probably could not be maintained permanently without foreign assistance, or a depletion of foreign exchange reserves, or an expansion of exports beyond the present capacity of the country's economy. The high figure indicates, however, that imports included at least some semi-luxuries and luxuries so that a reduction in volume might be possible without affecting the importation of necessities. Such a reduction might not necessarily require drastic government interference if the foreign trade multiplier could be expected to work also in a downward direction and to bring about a fall in imports some time after the fall in exports.

It is true that Turkey could utilize imported capital goods to a far greater extent than in the interwar period. Such imports, however, should be financed by commercial credits: Turkey's wealth in natural resources makes industrialization on a rational basis an undertaking that should appeal not only to the International Bank for Reconstruction and Development but also to private investors. Some credits probably would have been granted already if the international political situation had permitted greater confidence in foreign investments. If the European Recovery Program serves its purpose of stabilizing the international situation in Europe and the Near East, the main obstacle to such investments will be removed.

The preservation of equilibrium in Turkey's balance of current payments is extremely important not merely for the country itself--which could afford to live for some time on its accumulated reserves--but for the entire European Recovery Program. If Turkey should join the large group of countries that rely upon the United States to cover a chronic trade deficit--be it an overall deficit or merely one in dollars--the American funds available for other European countries would be depleted correspondingly. For the sake of the success of the European Recovery Program, Turkey should not merely eliminate the danger of a chronic deficit in its balance of current payments, but aim at reestablishing its customary export surplus and make available that surplus for financing imports of other participating countries that had less fortunate experiences during the war. In this way, the overall drain upon U.S. resources would be lessened and Turkey would set an important example of intra-European cooperation.

ONE YEAR OF HUNGARIAN STABILIZATION

C. B. Rose, Jr.

On August 1, 1946, measures designed to halt the hyper-inflation and to stabilize the currency were put into effect in Hungary. Data covering the twelve-month period ending July 31, 1947, are now available, and permit an appraisal of the first year of the stabilization effort.

Currency and Credit

When the currency was converted in August 1946, it was announced that emission of bank notes by the National Bank during the next year would be limited to 1 billion forint. This sum, it was believed, would be adequate for the needs of the economy in view of the deflationary policy to be instituted. The degree of deflation called for under the stabilization plan was found to be too severe in practice, and price and credit restrictions had to be relaxed. Consequently, the benchmark was exceeded in January 1947, and on July 31, bank notes were outstanding to the amount of 1,595 million forint together with subsidiary coins totaling 90 million forint.

An interesting calculation has been made1/ showing the purchasing power of the total volume of money in circulation relative to the value in January 1938. According to these data, the purchasing power, which had shrunk to 0.6 per cent of the base just prior to the stabilization, had risen to 51 per cent by the end of December 1946, but was still only 60 per cent at the end of May 1947, the latest date for which they are available. At that time Hungarian economic activity was estimated at about 70 to 80 per cent of the 1938 level. In relation, then, to the needs of the economy, the volume of money in circulation certainly could not be considered excessive.

The liquid resources of the commercial banks were virtually wiped out by the inflation, and the volume of funds at their disposal since stabilization has been insufficient to meet the credit demands of business and industry. Development of deposits2/ since stabilization has been unsatisfactory, partly reflecting distrust in the banks which have become instruments of government control over business and individuals. Moreover, the policy of credit restriction has limited recourse to the central bank. Loans on bills and current account advances on July 31, 1947, amounted to 1,154 million forint or only about 12 per cent of the volume extended at the end of 1938. Despite the measures taken to hold down central bank credit, rediscounts amounted to 745 million forint on the July date.

Since the appointment of State Controllers for the large Budapest banks (which account for almost all the banking business of the country) with power to supervise all their operations, the banks can grant only such credits as conform to the policy of the Government. This means that firms working on reparation orders receive priority in the allocation of credits. Many enterprises cannot obtain any credit at all, or can get it only on terms which raise their operating costs to levels at which, in view of the ceiling on prices, business becomes unprofitable.

1/ Gazdasagstatisztikai Tajekoztato (Economic Statistical Bulletin), Vol. 1, No. 7, p. 335.

2/ In 1937, there were 4.16 pengo of deposits for each pengo in circulation; in June 1947, for each forint in circulation there were only 0.45 filler of deposits (including all savings deposits).

National Bank

In consequence of the inflation the liabilities of the National Bank were almost entirely eliminated. In support of the stabilization plan the U.S. authorities returned the gold reserve of the Hungarian National Bank which had been recovered in the American zone of occupation in Austria. Additional assets accrued through the surrender of gold and foreign exchange after August 1. The first regular balance sheet was published for October 31, 1946, when gold and foreign exchange amounted to 333.4 million forint. The comparable figure for July 31, 1947, was 501.5 million forint. As a result of the increase in bank notes outstanding and other sight liabilities, the reserve ratio had fallen from 40.2 per cent on the earlier date to 32.5 per cent on the latter; the legal minimum is 25 per cent.

The composition of the National Bank's bill portfolio has altered considerably since stabilization. This is indicated in the table below. The increase in credits granted industry is explained by the demands of the heavy industries and the coal mines taken over by the State, which have been operating at a deficit. The share of agriculture, although larger than last year, is still relatively small, but foreign trade bills have doubled. In large part the latter originate under the Soviet-Hungarian trade agreement.

Table I
Distribution of the Bill Portfolio of the Hungarian National Bank

	August 31, 1946	July 31, 1947
	(Per cent of total)	
Industry	37.6	54.9
Agriculture	0.1	9.0
Public supply	43.9	10.3
Commerce	1.9	1.7
Foreign trade	11.4	22.2
Total (in million forint)	74.3	920.5

Although direct assistance of the National Bank to the Government consisted only of a medium-term loan of 300 million forint granted to permit the initiation of the stabilization plan, the National Bank's resources have been devoted increasingly to the coverage of items which otherwise would have been a charge upon the budget. Moreover, the State's share in the revaluation "profit" of the National Bank was of considerable assistance in permitting favorable results to be shown in the budget for the fiscal year 1946-47.

State Finances

The budget drawn up for the State under the stabilization scheme was revised in December 1946, ostensibly to allow for the higher level of prices.1/ Both expenditures and receipts for the year ending July 31, 1947, actually were at even higher levels. The results as shown, moreover, were more favorable than had been forecast. Thus, while the first budget estimated a deficit for the State alone of 300 million forint (to be covered by the National Bank loan) and the second a deficit of 254 million forint, published results show a surplus of 160 million forint. Since inspection of the figures reveals, however, that loans of 360 million forint are included in receipts, the actual deficit was 200 million forint. The State Enterprises are reported to have had a smaller deficit (108 million forint) than had been estimated, but bank loans of 114 million forint are included in their revenues. The combined surplus of 52 million forint shown, therefore, actually is a deficit of 422 million forint. It was to be expected that the published budget figures would show a favorable picture since the Government was under the political necessity of proving that the stabilization had been a success. In fact, it was necessary to resort to window-dressing.

Tax receipts, indeed, developed favorably during the year, although in part this may be attributed to rising prices. It is known, moreover, that the volume of tax arrears is considerable. Nevertheless, tax and monopoly revenues (accounting for 69 per cent of total government receipts including loans) covered 72 per cent of total expenditures. Extraordinary and non-recurring revenue items accounted for 11 per cent of total receipts. These items included the State's share of the National Bank's revaluation profit (245.6 million forint), seigniorage on the new coinage (83.3 million forint), and sales of goods secured through the U.S. Surplus Property Credit (44.4 million forint).

The most important charge on the budget is that carried under the heading "international obligations" which covers reparations, and supplies to the Red Army and the Allied Control Commission. Recorded outlays on this account were 1.4 billion forint or 39 per cent of total expenditures. However, the Government has large outstanding debts for reparations delivered but not paid for.2/ Efforts apparently have been made to offset these claims to some extent against arrears of taxes. Such an arrangement would have the advantage of concealing the actual extent of expenditures on account of "international obligations".

The heading "special expenses" contains items of interest. A 45 million forint "subsidy" was paid to counties and municipalities, largely on account of redemption of scrip with which farmers supplying the Red Army had been paid. For purposes of "foreign trade equalization", 202 million forint was expended by the Government. This was necessary primarily because of the unfavorable prices (below Hungarian costs of production) set by Russia on Hungarian products exported under the trade agreement. Other special expenses were subsidies to the State Coal Mine Administration and to the Heavy Industry Administration. These latter

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1/ The first budget was drawn up in 1938 pengo before the value of the forint had been decided upon, and converted to forint by multiplying by three throughout. The price level in forint as actually established was more than three times the 1938 price level in pengo. Cf. below, p. 14.

2/ For example, no provision has yet been made to compensate the Hungarian owners of the shares in the Petrozseny mines in Romania turned over to the Soviet Union on reparation account.

sums apparently do not cover the full deficit, banks being forced to extend credits which are, in effect, a contingent liability of the State.

Prices and Wages

The price level had been set in the stabilization plan on the basis of a formula which assumed that existing supplies of agricultural commodities available to the Hungarian population were about 50 per cent of the prewar level and industrial supplies about 25 per cent. To hold demand down to a point at which it could be satisfied, it was decided to set the level of industrial prices above that for agricultural commodities, and for each of the two groups, in relation to supply possibilities. The point of departure for agricultural prices was the new price for wheat, traditionally the staple commodity of the Hungarian economy. This was set at 400 forint per ton or about 2.1 times the 1939 pengo price. A weighted average for the increase decreed in all agricultural wholesale prices was 3.2 times the 1939 level. Industrial wholesale prices were established at an average level somewhat over five times the 1939 level. The margin between industrial wholesale and retail prices was permitted to be greater than that between agricultural wholesale and retail prices. This placed the farmer at an even greater disadvantage than the relationship between the levels of the two groups of prices would indicate, since he sold his produce at the wholesale price, but had to pay retail prices for the industrial goods he bought.

Initially, the official prices were the actual prices in effect throughout the country for all transactions. By early winter, however, the re-emergence of a black market in many commodities, and the complaints of all groups in the economy, forced the Government to make changes in the price structure. To satisfy the farmers, "free" markets were permitted in a number of agricultural commodities, and some industrial prices lowered from the original level. Subsequently, however, it was found necessary to permit increases in industrial prices. Pressure from farm interests became even greater, and prices of agricultural commodities were raised substantially. For instance, the price set for wheat delivered under the required surrender program in the summer of 1947 was 800 forint per ton. The free market price is reported to be far higher. At the time of stabilization the index for agricultural wholesale prices was 330 on a 1939 base, and that for industry 457; on August 31, 1947, the agricultural index had risen to 572 while the industrial index was only 502. This would indicate that not only had the "scissors" been closed but opened in reverse. Official prices, upon which the table below is based, have become less representative of prevailing prices than at the start of the stabilization plan, and consequently even the substantial increases shown in Table II do not fully indicate the extent of the rise which has taken place.

This development in prices made it impossible to maintain the stabilization of wages. The original plan used a multiplier of three relative to 1939 in setting wages in the collective bargaining agreements which was computed to have placed the purchasing power of the worker at 50 per cent of prewar. Wages of white collar workers were set so that they received even less of their former real income. Rising prices made these low levels intolerable, and upward revisions in these rates had to be allowed. Salaries of government workers were increased 15 per cent in July 1947, while the collective bargaining agreement likewise was revised to permit an increase in wages of workers which it covers.

Table II
Development in Prices

	12/31/46	8/31/47	9/30/47	10/31/47
Wholesale prices: Aug. 31, 1946 = 100				
Agricultural products	97.9	173.3	173.3	186.1
Agricultural industry	96.4	102.9	104.2	104.4
Other industry	99.8	109.8	112.9	113.1
Combined	98.7	129.6	131.3	135.6
Cost of Living: Sept. 1946 = 100				
Food	116.5	121.7	135.6	172.8
Clothing	102.8	118.2	123.5	123.5
Heat and light	95.0	96.0	96.0	98.2
Rent	100.0	100.0	100.0	100.0
Other necessities	91.1	85.9	85.9	85.9
Combined:				
with rent	107.9	111.9	120.1	141.2
without rent	108.9	113.3	122.6	146.3

Foreign Trade

The foreign trade of Hungary for the postwar period prior to stabilization was very small, according to reported figures. After stabilization, with official foreign exchange rates once more enforced and the gradual resumption of foreign commercial relations, the volume of imports and exports rose. Results for the whole year, however, were disappointing. In the first five months after stabilization, exports exceeded imports. For the rest of the year the situation was reversed, and the total deficit for the twelve months amounted to 100 million forint. Importation of goods under the U.S. Surplus Property Credit contributed to this result. During the year ending July 31, 1947, Hungary imported goods from the United States amounting to 221 million forint and exported goods to this country in the amount of only 13.2 million forint. In contrast, exports to Russia totaled 174 million forint while imports from the Soviet Union are shown as 105 million forint. It was noted above that the prices allowed Hungarian exporters to the Soviet were not realistic and entailed support from the Government. Moreover, the proceeds are not freely disposable and Hungary is in a poor position to export capital to Russia. On the other hand, exports to Switzerland, which exceeded imports by 56 million forint, served as the means of securing free foreign exchange.

The difficulties for Hungarian foreign trade created by the artificial exchange rate1/ have been avoided in many instances by the conclusion of barter-type trade agreements. Under the law, all foreign exchange must be surrendered to the National Bank, and there is no legal free market. Although immediately after stabilization the black market in foreign exchange and gold almost disappeared, it has revived. The latest reports quote rates of about 30 forint to the dollar, compared with an official selling rate of 11.85; some individual transactions are reported at rates as high as 50 to the dollar.

1/ For a description of the method used for fixing the exchange rate, cf. this Review, April 22, 1947, p. 15.