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THE FRENCH MONETARY MOVE

Albert O. Hirschman

On January 25, 1947, the French Government devalued the franc by 44.44··· per cent, thus raising the official buying rate for the dollar from 119 to 214 francs. In addition, the Government decided upon the creation of a free market in gold and an open market for foreign exchange, in which at first only U.S. dollars and Portuguese escudos are to be traded. This market will be supplied by one-half of the dollar (or escudo) proceeds from exports and by the dollars received from tourists, other invisible current transactions, and from the import or repatriation of capital. The demand in the market will originate from licensed importers of non-basic commodities while importers of basic commodities can purchase dollars from the Exchange Control Office at the lower official rate. The open market dollar established itself at 310 francs, somewhat lower than the previous black market price for dollar notes. At this rate the average franc yield of one dollar earned by exporters amounts to $\frac{214 + 310}{2} = 262$ corresponding to a 56 per cent devaluation, while the tourist and the American importer of capital obtain the full benefit of the free rate, corresponding to a devaluation of 62 per cent. The French capitalist who repatriates his dollar balance is given a full amnesty for the evasion of exchange control legislation implicit in his dollar holdings provided he pays a tax of 25 per cent.

This tax reduces his proceeds from 310 to 233 francs per dollar, still leaving a margin over the official rate of 214. There are, therefore, three different effective selling rates (262, 310, and 233) and two effective buying rates for the dollar (214 and 310). Since the franc rates for other currencies correspond to a dollar rate of 214, the application of the higher rates for the dollar for all operations with the dollar area except payments of essential imports results in cross rates placing currencies other than the U.S. dollar at various discounts with respect to their official dollar parities.

The French decision was preceded by an international discussion during which strong opposition to the French plan developed on the part of the British Government and of the International Monetary Fund, which both favored a flat devaluation. In spite of strenuous efforts at reconciliation, and several concessions on the part of the Fund, no final compromise could be achieved and the French Government decided to enact its plan over the objections of the British Government and the Fund.

The United Kingdom was especially opposed to the French scheme because of the discount of the pound with respect to the dollar that was expected to develop in the Paris market, while the Fund was opposed to it on the more general ground that it ran counter to the processes of orderly exchange rate adjustment which the Fund was set up to achieve. These reasons for the positions taken by the British Government and the Fund are strong ones and do not stand in need of much elaboration. What does require an explanation is the unyielding attitude of the French Government and its determination to embark upon its own scheme regardless of its prejudicial effects on the cause of international monetary cooperation.

The Objectives of the French Scheme

An explanation of the French action may start with a consideration of the objectives sought by the French Government. Criticism of the French proposals has not generally been levied against these objectives in themselves. Rather it has been maintained

(a) that the methods used to achieve them are objectionable, and that less objectionable methods are available; and/or

(b) that the plan is not likely to achieve the stated objectives.

The French goals were essentially the following:

(a) to foster exports in general and exports to the dollar area in particular by means of a greater devaluation of the franc with respect to the dollar than with respect to other currencies;

(b) to recapture the tourist and other invisible income from the black market where it had served to finance illegal capital exports rather than essential imports;

(c) to encourage the repatriation of French capital held abroad and the dishoarding of dollars and gold held internally;

(d) to establish an open market for certain categories of foreign exchange. This was a means to achieve the previous objectives, but it is important to realize that it was also an end sought for itself. In fact, the French Government rejected most of the available alternative ways of achieving (a), (b), and (c) because it considered the open market an essential part of its plan. The reasons for this attitude will be examined below.

The Case for a Differential Devaluation with Respect to the Dollar

In propounding a scheme that was certain to result in a differential devaluation of the franc with respect to the dollar, and therefore in the existence in Paris of non-official cross rates between the dollar and other currencies, the French argued that the franc was less overvalued with respect to European currencies than with respect to the dollar. As was shown in a previous article,1/ this statement is of dubious validity if interpreted in terms of comparative price movements. It cannot be contested, on the other hand, if overvaluation is understood as merely another expression for difficulties encountered in exporting. French exports to the United States did fall off long before any obstacles to the expansion of exports to other markets became apparent. One important reason for this development is the fact that France's exports to the United States are predominantly price-sensitive luxury goods.

Difficulties in expanding sales to the United States are not peculiar to France. During 1947, exports to the United States of all countries participating in the European Recovery Program showed virtually no advance over 1946,2/ while total exports of these countries expanded by 45 per cent.3/ These figures give some support to the thesis that, on the whole, European currencies are not overvalued with respect to each other and with respect to non-dollar currencies in general, but that adjustment is needed with respect to the dollar. If that is the case, three solutions can be conceived:

(1) an appreciation of the dollar;

(2) a collective readjustment of European currencies;

(3) excluding the two previous possibilities on practical grounds, it would become necessary to proceed to successive differential devaluations with respect to the dollar or to indirect measures achieving essentially the same result.

In fact, even opponents of the French scheme recognized the need for France to enact special measures in order to expand sales in the Western Hemisphere. But being opposed to the creation of an open market with its non-observance of official cross rates, they pointed out to the French that the same end could be achieved by quantitative direction of the

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1/ See this Review, September 23, 1947.
2/ U.S. imports during the first eleven months of 1947 from the ERP countries amounted to $628 million as against $606 million in 1946.
3/ Calculated from International Financial Statistics, January 1948, p. 21.

flow of exports either by means of direct controls or by monetary incentives of an internal character such as, e.g., differential freight rates. The psychological impact on the standing of other currencies was certain to be smaller under any such system than the open discount on other currencies resulting from the open market quotations in Paris. Commodity arbitrage operations (e.g., imports of Australian wool or Scotch whisky into the United States via France) would also have been more easily prevented although it seems likely that even under the present system such practices can be effectively ferreted out.

Although a lesser evil from the Fund's point of view, a system of quantitative restrictions and other devices designed to discriminate in favor of one country would certainly not have been an ideal solution. In any case, the French found the idea unacceptable because they desired less rather than more controls and because they wished to organize an open market in any event for purposes of invisible and capital transactions.

No consideration seems to have been given by the French to the difficulties likely to arise from the coexistence of different import and export rates. These difficulties which were largely instrumental in putting an end to the original Italian Fifty Per Cent System[1/] stem from the fact that French producers have to import raw materials and equipment from the dollar zone at a higher rate than that at which they can subsequently export their manufactures. The export rate is either the average rate between the official and the open market rate or simply the official rate, in the case of exports to non-dollar areas, while the high open market rate will apply to dollar purchases of all commodities except grains, fats, fertilizer, and fuel.[2/] This disparity is therefore the opposite of an export premium and will place at a disadvantage exports containing dollar raw materials (such as American cotton) which are not on the preferential list. Such difficulties could have been largely avoided by requiring the licensed importer to acquire only half of the needed exchange in the open market, and by supplying the other half at the official rate.

<u>The Prospect for Capital Repatriation</u>

However great the need for exports to the dollar area, it cannot possibly explain by itself why the French Government decided to defy the Fund and not to compose its differences of view with the British Government. Total French exports to the Western Hemisphere in 1947 amounted to only \$170 million (of which \$50 million to the United States) as against an estimated current account deficit of \$1,510 million (of which \$1,480 million with the United States). To achieve a really substantial improvement in its payments relations with the dollar area, France needed, in addition to increased export proceeds, larger dollar receipts from tourists and from capital imports and repatriations.

Here lies the strongest justification for the French scheme. The Italian experience had conclusively demonstrated that tourists and importers of capital will finance themselves largely through the black market unless

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1/ See this <u>Review</u>, December 16, 1947.
2/ Avis N.292 of the Office des Changes.

the legal rate closely approximates the black market rate.[1] However, a devaluation of the franc to the prevailing black market rate would clearly have undervalued the franc unduly for trade purposes. This was recognized by the Fund, which was willing to let the French create a free market for invisible and capital transactions <u>only</u>, i.e., exclusive of one-half of the proceeds from exports.[2] But here again the French found it impossible to compromise presumably because the elimination of export proceeds would deprive the market of the principal steadying influence on the supply side and, more important, because it would make the market appear, to an extent altogether unpalatable politically, as a simple device for subsidizing the owners of flight capital.

Is it likely that the French will achieve the objectives of "capturing" tourist receipts and of inducing capital repatriation? The two parts of this question are closely tied together; for unless the outward flow of capital is stopped an extra-legal demand for dollars will re-emerge and will soon create a new black market offering a more advantageous rate to the tourist than even the "free" market. Owing to a partly purposeful, partly accidental, combination of circumstances, both the "carrot" and the "stick" are at hand in the present French situation, to encourage the repatriation of capital held abroad or the dishoarding of internally held dollars.

The carrot consists of the amnesty for past exchange control violators and the attractive rate. There is, furthermore, the assurance given to those who convert their dollars into francs that they will be able to convert francs back not into dollars but into gold through the legalized internal gold market. This was probably one of the main purposes of the new gold legislation.

The French Government has not one but three sticks at its disposal. First, of course, there is the recent action of the U.S. National Advisory Council on blocked assets which is likely to bring strong pressure for liquidation on owners of this type of undeclared assets. Some dishoarding of dollar notes held in France is also likely to take place in psychological reaction to the introduction of a bill in Congress proposing to carry out an exchange of U.S. currency in circulation with the object of "smoking out" the foreign hoarders.

Secondly, the amnesty granted to exporters of capital is only a temporary one inasmuch as the 25 per cent tax on the franc proceeds of repatriated dollars will gradually increase after July 1948. It is true that the only dollar holders who will pay this tax probably are the owners of blocked assets in the United States who are now likely to repatriate in any event. Owners of free assets who wish to repatriate will have little trouble in making the transfer through a U.S. citizen who, as an importer

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1/ In Italy the granting of the average between the free and official rate had failed to direct tourist expenditures into official channels.

2/ Another possibility would have been the establishment of a variety of the Italian "<u>franco valuta</u>" system (see this <u>Review</u>, May 6, 1947), in which capital is repatriated in the form of authorized imports with the exchange rate implicit in the relation of purchase to sales price of the imported merchandise. But what the French wanted was precisely an <u>explicit</u> exchange rate.

of foreign capital, will obtain the full benefit of the free rate. The French Exchange Control Office has already announced that the tax will not apply to holders of dollar notes, probably in recognition of the fact that enforcement would be wholly impossible.

A more effective and fundamental step on the French side is, finally, the deliberate creation of a general shortage of cash which is expected to lead to the liquidation of hoarded commodities, gold, and dollars. After the 64 per cent rise in prices between July 1947 and January 1948, as against an increase in circulation of only 7 per cent, a considerable shortage of cash may be expected to develop as the result of the recently enacted exceptional levy (to be paid either by subscription to a three per cent loan or as a tax) which is supposed to yield 125 billion francs; of the withdrawal and partial blocking of 5,000 franc notes which had made up over one-third of the total circulation; and of continued stringent qualitative bank credit control.

Altogether, therefore, a number of conditions are present which should force some dishoarding of dollar assets during the coming months. Two important conditions, however, are not fulfilled -- that is, assurance of political stability and of continuity of foreign aid. Prompt passage of the European Recovery Program would materially help in rounding out the chances of success for the French program to recapture some of the "hidden wealth" of the nation.

The Open Market

Possibly the principal stumbling block in the way of a compromise between the French and the Fund was the French determination to create a "free" market. This determination arose, in part, out of the current attempt of the Government to reduce the controlled sector of the economy; the reestablishment of an exchange market at the Paris Bourse, however limited and controlled, was considered a step in the right direction. Furthermore, the Government may have held (by analogy with the experience of the interwar period) that the existence of a market would, by its reactions, be of great help in rallying public opinion to the support of anti-inflationary policies.

Finally, the originators of the French plan probably still had in mind the successful stabilization of the franc by Poincare in 1926/28. This stabilization was de facto for two years before becoming de jure, and there was a continued influx of dollars and gold all through this period. From the point of view of public psychology it is probably true that a currency that does not fluctuate for a prolonged period, in spite of the fact that, at least technically, nothing prevents it from fluctuating, is likely to inspire a maximum of confidence. Since the French authorities were convinced that they could circumscribe the fluctuations of the open market by the control held over the demand side, they presumably thought that they could repeat the Poincare performance. To the extent that the open market is merely manipulated by the exchange control authorities, any stability it might display would be, of course, purely artificial; and an attempt to win public confidence on the basis of such an artifice can be successful only as long as the French public fails to see through it. The question therefore arises as to the real nature of the open market which has been established.

In the discussion of the French devaluation, those opposed to the measure have maintained alternatively that the established market is free only in name or that the fluctuations that are likely to occur on it would be uncontrollable and would endanger the stability of all other currencies. The defenders of the new system have retorted alternatively either that the market is subject to the free play of economic forces or that the French authorities may be relied upon to have the market well in hand.

The truth lies naturally somewhere between these two contradictory lines of argumentation. Ultimate control of the market will be exercised by the French Exchange Control Office which determines, by its licensing policy, who can enter the market as a bidder. A certain unmanageable element on the demand side, however, derives from the fact that an importer who has obtained an import license may considerably vary the date of actual utilization of that license or may even decide, should the dollar become too expensive, not to utilize it at all. On the supply side some flexibility is provided by the stipulation that exporters can hold their dollars for a maximum of one month before sale on the market. The major element of uncertainty in the market is, of course, the prospective offer of dollars on the part of owners of flight capital.

It is clear, therefore, that the market, though basically manipulated, can still diverge materially from the planned pattern in the short run. In the longer run, everything depends on the policies followed by the Exchange Control Office. The authorities might respond to an upward tendency of the dollar rate by a more restrictive policy in granting import licenses, or they could prefer an appreciation of the free rate of the dollar to a further restriction of imports. Whatever the decision, it will most likely be a <u>reaction</u> to market forces which will have had an opportunity to make themselves felt.

The foregoing discussion has attempted to present the French Government's motives, known and inferred, for the perplexing and unfortunate decision to disregard the objections of the Fund. The realization that the French case was not without its points on substantive grounds makes one regret the more keenly that the French Government should have chosen the course of unilateral action in carrying out its plan.

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ERRATUM

In column 2, Table I (p. 10) of the article on "British Payments Agreements and Sterling Agreements Since August 20, 1947" in the <u>Review</u> of January 27, 1948, the figure of the maximum net balance to be held in the #1 sterling account of the J.F.E.A. was given as £15 million. It should have been <u>£1.5 million</u>.

BALANCE OF PAYMENTS OF THE NETHERLANDS INDIES IN 1947 J.B. Churchill

The Netherlands Indies has had a continuous deficit in its balance of payments on current account since the resumption of foreign trade after V-J Day. Imports have greatly exceeded exports in contrast to the prewar situation in which an export surplus provided foreign exchange to cover large payments of dividends and other invisibles. The major portion of the 1947 deficit can be attributed to: (1) diminished productive capacity and disorganized transportation in the Indies together with an inadequate supply of consumer necessities to secure the services of native labor in production for export, (2) additional loss of export proceeds to the Dutch authorities resulting from divided political control in the Islands, and smuggled exports from Dutch-held areas, which were only partly offset by return of imports into Dutch-held territory, (3) increased capital goods imports to replace production plant impaired or destroyed in both the war and postwar periods, and (4) an unfavorable change in the terms of trade since prewar. Although inter-governmental credits and new private investments have helped to finance the balance of payments deficit, official and reported private net short-term assets in the United States have declined 39 per cent in the past two years. The drop in these assets from December 31, 1945, to December 31, 1947, amounted to $43.5 million. Gold holdings in the United States, which constitute the larger part of the Javasche Bank's required reserves against its demand liabilities, have not been utilized in financing the deficits.

The following table presents incomplete estimates of the 1947 balance of payments of the Dutch-held areas in the Archipelago and excludes territories under the sovereignty of the Indonesian Republic. During the year there was a considerable increase in the area under Dutch control at the expense of the Republic. The construction of this table places emphasis on transactions with countries other than the Netherlands. For a number of items it is difficult to arrive at accurate estimates of payments to the Netherlands, and in any case the balance of payments with the Netherlands is not of great significance since the deficits with the Netherlands have been financed semi-automatically by increased liabilities of the Indies to the Dutch Government and banks.

The deficit on current account with countries other than the Netherlands is estimated at $192 million. Certain capital transactions which are known or can be accurately estimated are shown in the table. These served to finance $86 million of the deficit. There were three principal sources of foreign exchange to finance the remaining unexplained difference of $106 million.

Netherlands Indies
Balance of Payments, 1947
(In millions of U.S. dollars)

	All countries other than Netherlands					
	Total	United States	Other Western Hemisphere, Japan, and Philippine Islands	Other	Netherlands	Total
Current Accounts						
Payments:						
Merchandise imports (c.i.f.) a/	241	105	40	96	35	276
Other invisibles	12	4	0	8	22 c/	33
Receipts:						
Merchandise exports (f.o.b.) b/	61	23	3	35	64	125
Deficit on current account	192	86	37	69	(+5) c/	
Known (or Estimated) Capital Movements						
Payments:						
Retirement of NEI Funded Debt held in Netherlands					d/	
Repayment of inter-government loans	2	2	0	0	e/	
Liquidation of foreign-held assets in NEI	f/				e/	
Receipts:						
Disbursements on inter-government loans	28	12	3	13	0	28
New foreign investment in NEI	g/				g/	
Net liquidation of long-term investment abroad	2	2	h/	h/	e/	
Decrease in gold and net short-term assets held abroad	58	58 i/	e/	e/	e/	
Known (or estimated) balance on capital account	86	70	3	13	c/	

a/ Exclusive of imports on account of the Indonesian Republic and the Armed Forces of the Dutch. November and December estimated.

b/ Exclusive of the commerce of the Indonesian Republic and clandestine exports from Dutch-held areas. Inclusive of export duty. Nov. and Dec. estimated.

c/ Incomplete. The significance of surpluses or deficits with the Netherlands on current account or on current and long-term capital accounts combined is not great, because they are currently offset by changes in the N.E.I. Government Floating Debt held by the Netherlands Treasury and in inter-bank accounts.

d/ The total Funded Debt held in the Netherlands and N.E.I. decreased by $14.6 million during 1947.

e/ Figures not readily ascertainable. f/ Allocations of foreign exchange are not made for the repatriation of long-term capital owned in the N.E.I.

g/ Large investments by U.S., Netherlands, and U.K. companies may have taken place in 1947, but reported imports which might have been financed by such capital movements can not be accurately estimated.

h/ Believed to be negligible. i/ Excluding $20 million decrease in gold used to meet N.E.I.'s contribution to the Netherlands' subscription to the IMF.

It is reasonable to believe that a major part of this difference was financed by investments by U.S. and U.K. firms for which no entry has been made in the table.1/ Estimates available here, confirmed by Dutch opinion, indicate that around \$50-\$55 million of private investment came from the United States in the form of imports, practically all of which arrived in 1947. A similar amount is believed to have been invested by jointly-controlled Dutch and British companies, but the part attributable to British investment is not known. Part of the imports financed by private capital are omitted from the Netherlands Indies trade statistics shown in the table; some imports for reconstruction and rehabilitation of oil refineries in Republican-controlled areas of Sumatra occurred prior to their reacquisition by the Dutch in August. Therefore, a portion of the investment just mentioned cannot be used to explain the amount of \$106 million.

The Netherlands Minister of Finance was authorized to extend credits up to 800 million guilders (\$305 million) for the years 1945, 1946, and 1947. Such credits, the major part of which doubtless has been required to finance expenditures for goods, services, and capital transactions in the Netherlands (which are not fully covered in the table) were, however, available in part to finance capital goods imports by the Netherlands Indies from other countries. There has apparently also been an increase in short-term debts of the Indies to Netherlands banks, some part of which may have reflected transactions with other countries. It should be noted that some of the Indies exports to the Netherlands are probably processed and re-exported, yielding foreign exchange for repayment of current liabilities to the Netherlands Government and banks.

A small part of reported imports was financed with receipts derived from illegal exports. Under the controls in effect up to January 1, 1948, licenses were required only for those imports which were paid for with foreign exchange allocated by the Foreign Exchange Institute. Other imports, particularly of consumer goods, apparently entered through official channels and were recorded in the trade statistics.

Sterling balances of the Netherlands Indies reported by the Dutch Government as of September 30, 1946,2/ were too small to have financed any significant portion of the deficit incurred in 1947. Liquidation of Netherlands Indies long-term sterling investment has not been a source of receipts because U.K. exchange controls have reduced to a negligible amount the outflow of foreign-owned long-term capital from the sterling area.

1/ Trade statistics do not provide a close check on the amount of private investment. Officially reported imports in 1947 of capital goods which might have been financed by capital movements from the United States and the United Kingdom probably did not exceed \$30 million. It is believed, however, that a large part of the investment expenditure was for the purchase of inducement goods (principally foods and textiles) to obtain the services of native labor.

2/ Kingdom of the Netherlands, Prospectus, \$20,000,000 Bonds of 1947, May 26, 1947.

END OF THE SYRO-LEBANESE UNION? J.H.F.

The recent devaluation of the French franc has had unexpected repercussions in Syria and Lebanon. As a legacy of the French mandate terminated by the second World War, these two countries have retained a common currency, the Syro-Lebanese pound. This currency is issued by the French-controlled Bank of Syria and Lebanon and is covered mainly by that Bank's holdings of French francs. The common currency formed the basis of the Syro-Lebanese Economic Union, established in January 1944. The SL pound formally is pegged to the French franc. In 1944, however, the representative of the "Free French", General Catroux, gave assurance to Syria and Lebanon that the value of the pound would be maintained in terms of sterling against any franc devaluation. The French Government advised Syria and Lebanon in 1946 that the Catroux guarantee had been satisfied by the upward adjustment of the franc holdings of Syria and Lebanon in connection with the devaluation of the franc in December 1945, and that the guarantee would not apply to future changes in the value of the franc; Syria and Lebanon refused to accept this interpretation. In 1947, Syria and Lebanon joined the International Monetary Fund; the parity rate of the SL pound was established at 45.6313 U.S. cents, corresponding to the then prevailing exchange rates between the SL pound and both the French franc and the pound sterling.

For several months Syria and Lebanon have conducted negotiations with France on the renewal of the exchange guarantee, the settlement of various mutual claims arising out of the French occupation of Syria and Lebanon in the interwar period and during the second World War, and a general clarification of the financial relations between Syria and Lebanon and the French franc area. The guarantee against devaluation, however, became a burning issue when the franc actually was devalued in January 1948. France reached a settlement with Lebanon, the exact provisions of which have not yet been made public; according to unofficial reports, France has agreed to renew the exchange guarantee for that part of the note cover that is held in francs, and to make a generous settlement of the outstanding claims, while Lebanon has agreed to remain within the French franc area for a period of ten years. France gave Syria until February 6 to adhere to that agreement. Syria, however, has refused to enter into a new long-term currency union with France, and has stated its determination to sever completely the ties between its currency and the franc, and to appeal to the International Court at the Hague for a settlement of the remaining financial disputes.

This decision, if actually carried out, would mean the end of the common Syro-Lebanese currency. Lebanon immediately announced the exchange of the circulating bank notes into a purely Lebanese currency, at the rate of 1:1; in future the Syrian currency will no longer be legal tender in Lebanon. Syria, however, has not as yet taken any similar step.

As a further consequence, France might continue to allocate hard currency to Lebanon (although it has not assumed an obligation to do so), but certainly would cease allocations to Syria. Under such circumstances the union between Syria and Lebanon hardly could be maintained effectively even in the restricted field of foreign trade. The Syrian Prime Minister has declared that the country "can easily raise the necessary amounts of hard currency to cover purchases from abroad and to supply the nation with industrial and agricultural equipment." In view of the permanent scarcity of hard currency from which both Syria and Lebanon have suffered in spite of the previous French allocations, this statement appears optimistic. Despite strong words used by the Syrian Government, Syria may adhere to the treaty between France and Lebanon after all, and thus save the Syro-Lebanese Economic Union. Ending the Union would create serious problems, for which neither country has prepared a solution.

RUSSIAN INDUSTRY IN 1947

Alexander Gerschenkron

The report of the *Gosplan* still follows the exasperating practice of withholding absolute data on the growth of industrial output. It contains, however, the statement that output in the last quarter of 1947 equaled the average quarterly output in 1940, and exceeded the output in the last quarter of 1946 by 30 per cent. Furthermore, it is said that industrial output in 1947 was 22 per cent higher than that of 1946. Since the output for the year 1940 was previously given in absolute values (1926-27 rubles) it is possible for the first time, assuming a uniform geometric rate of growth from quarter to quarter in 1947, to compute, within a narrow margin of error, the absolute values of output in 1946 and 1947. Since the value of output for 1945 was previously divulged in a similarly oblique fashion, an index of Russian industrial production for the years 1945-47 can be computed, and is shown in the following table.

Industrial Output in Russia, 1940, and 1945-47

	In billions of 1926-27 rubles	1940 = 100
1940	138.5	100
1945	127.0	92
1946	103.0	74
1947	126.0	91
1950 (Plan)	205.0	148

The foregoing figures indicate that industrial output in the last war year was only 8 per cent lower than in 1940. In the following year, however, it fell by 19 per cent to a level 26 per cent below prewar. This decline must be regarded essentially as a consequence of the losses which are implicit in the process of reconversion to peacetime production. It must also be attributed in some degree, however, to the failure of the annual plan for 1946 to provide for a sufficient increase in the supply of consumers' goods. The result was a considerable decline in labor efficiency and widespread absenteeism in the factories. By the autumn of 1946, the dangers of the situation were recognized by the Government, and great efforts were made to amend the plan and to assure a large supply of consumers' goods. The increase in output in 1947 looks impressive. It must be considered, however, that output in 1947 was still one per cent below that of 1945. A large number of plants reconverted in 1946 must have begun producing in 1947. Therefore, it would be erroneous to draw conclusions from the 1946-47 increase as to the rate of growth in the remaining years of the current Five Year Plan, 1948-50. Further increases in output will require disproportionately large investments of new capital.

Since industrial output is scheduled to increase to 148 per cent of prewar by 1950, attainment of this goal would imply an annual average rate of growth of 18 per cent. This may not be altogether impossible in view of past Russian records. Nevertheless, as will be shown presently, the past development of steel output makes attainment of an 18 per cent per year rate rather dubious. The Russian press in the last few months has been full of exhortations to fulfill the Plan within four instead of five years. This would imply that in 1948 and 1949 output must increase by 28 per cent a year; in other words at a rate very much higher than that which was obtained in 1947 under quite unusual circumstances. It appears altogether unlikely that such a rate could in fact materialize.

Concerning the breakdown of industrial output by classes of commodities, the report of the Gosplan (as was the case in the preceding years) presents only two sets of percentages. The percentages refer (1) to the degree of fulfillment of the Plan in the individual branches of Russian industry, and (2) to the relation of the 1947 output of physical quantities of important industrial commodities to that of 1946.

No absolute figures are reported. Nevertheless, estimates in absolute terms are available for some basic industrial materials. These estimates, together with data for 1940 and the targets for 1950, are shown in the following table.

Estimated Output of Certain Basic Industrial Materials[a/]
(In millions of metric tons)

	1940	1945	1946	1947	1950 (Plan)
Pig iron	14.5	8.9	10.0	11.4	19.5
Steel	18.8	12.0	13.1	14.3	25.4
Oil	31.0	19.4	21.7	25.8	35.4
Coal	165.5	142.0	156.2	175.0	250.0

a/ The estimates for the years 1945, 1946, and 1947 have been revised downward for coal and steel as compared with previous data given in this Review (March 25, 1947). The revision of the former is based on a speech made by Malenkov in September 1947; the revision of the latter is based on a recent oblique statement of the Ministry for Ferrous Metallurgy.

These figures would seem to reveal the precariousness of the present situation. They indicate that a volume of industrial output about 3 per cent lower than before the war is supported by an output of pig iron which is 21 per cent below prewar, an output of steel 24 per cent below prewar, and an output of oil 17 per cent below prewar. The oil deficiency is somewhat offset by a 6 per cent increase in the output of coal which amounts to about 4 per cent in terms of the oil equivalent.

From the foregoing table the past rates of growth and those necessary for the attainment of the 1950 targets for each of the four commodities can be computed as follows:

Average Annual Rates of Growth, 1945-47, and
Required Rates for Attainment
of 1950 Targets
(In per cent)

	1945-47	1947-50
Pig iron	13.2	19
Steel	8.9	21
Oil	15.5	11
Coal	11.0	12.4

Output of coal and oil undoubtedly has developed favorably. In the case of coal, only relatively slight stepping up of the annual rate of increase would raise output to the 1950 target. For oil, an increase in the annual rate of output by less than 2 per cent from that observed in 1945-47 would permit attainment of the goals of the Five Year Plan by the end of 1949. This is partly the result of the fact that the 1950 target for oil is relatively low in terms of prewar output. It was in regard to oil that the slogan of completing the Five Year Plan in four years was first issued. But the situation is substantially different in ferrous metals. It is very doubtful indeed that the huge increases in the rates of growth of output of iron and steel will in fact be accomplished, so that the Five Year Plan targets can be fulfilled by 1950. Steel indeed has been for some time and is likely to remain the main limiting factor in Russia's industrial development. The ratio of steel output to total industrial production appeared unduly low in Russia before the outbreak of the war. It would seem that failure of steel output to attain the goals will inevitably entail a slower increase of the aggregate industrial output, and prevent it from attaining the levels foreseen by the Five Year Plan. Still less will it permit an abridgment of the Plan period by 20 per cent.

Finally, a curious discrepancy between the two sets of percentages as published by the Gosplan may be pointed out. Early in 1947 the Gosplan published a series of target figures for the prospective percentage increase in 1947 over 1946 for the output of many individual commodities. With these data, it is possible for the first time to compare the goals with the actual performance and with the claims of the individual ministries as to the degree of Plan fulfillment. The data on Plan fulfillment, given by the individual Economic Ministries, show that of 29 ministries only five underfulfilled the Plan; of these the Ministry of Transportation Machinery showed the greatest lag, amounting to 6 per cent. Exact fulfillment is recorded in two cases, while 21 ministries show overfulfillment which in some cases is substantial. A very different result, however is obtained from a comparison of the targets for the 1947 commodity output with actual achievement. Out of 31 key commodities for which comparison is possible, 18 did not reach the planned increase over 1946; in two commodities the target was attained; and in the remaining 11 commodities overfulfillment of the targets occurred. While the overfulfillment on the whole is relatively small, the underfulfillment refers to the most important products, such as iron and steel, copper, industrial timber, cement, automobiles, tractors, and steam turbines. While output of pig iron rose by 14 instead of 21 per cent, that of crude steel by 9 instead of 19 per cent, and that of rolled steel by 15 instead of 21 per cent, the plan for the Ministry of Ferrous Industry is stated to have been overfulfilled by 1 per cent. Output of tractors increased by 9 per cent instead of the planned 87 per cent; the corresponding figures for automobiles are 30 and 57 per cent; but the Ministry of Automobiles and Tractors shows an underfulfillment of only 2 per cent. The Ministry for Building Materials shows an overfulfillment by 1 per cent, while cement output increased 40 per cent instead of 71, that of window glass 19 per cent instead of 42, and that of industrial timber 26 per cent instead of 47; only output of slate shows an increase by 39 instead of 30 per cent. The Ministry for Light Industry is stated to have overfulfilled the Plan by 6 per cent, but its most important product, leather footwear, increased by 40 instead of 42 per cent.

There may be a twofold explanation for these discrepancies. First, it is not unlikely that the data on Plan fulfillment by the individual industries refer not to the original plans as made at the beginning of the year, but to plans as adjusted in the course of the period. If this is true, the percentages of Plan fulfillment lose even such limited value as they may otherwise have. Second, since the data on output of the individual ministries must be given in value terms (at 1926/27 prices), it is possible that the enterprises, in order to have a record of overfulfillment, tend to concentrate on the output of relatively high-priced goods, and neglect that of relatively low-priced goods. If this supposition is correct, it would mean that the desire to fulfill the Plan not only causes, as is frequently assumed, a deterioration in the quality of output, but also leads to distortions through unplanned changes in the composition of output. In other words, fulfillment or overfulfillment of the Plan may conceal substantial underfulfillment in certain commodities that may be crucial to the development of the economy, and may entail a faulty allocation of resources.

U.S. EXPORTS TO U.S.S.R. DURING 1947 — G.H.F.

United States exports to the U.S.S.R. were at an annual rate of \$145 million during the first 11 months of 1947, and were only 40 per cent of such exports in 1946 when they amounted to \$358 million. The lower level of 1947 exports from the United States to Russia may indicate a return to the prewar status; prior to 1941 Russia's trade with the United States had been very small. Early postwar trade levels had been bolstered by UNRRA and lend-lease shipments, which virtually ceased during 1947. Russia is still receiving a small amount of capital goods on both UNRRA account and the modified lend-lease plan whereby arrangements for repayment are completed prior to exportation. The United States dropped some export controls during 1947, but the Second Decontrol Act of 1947 continued control of exports of, e.g., tin and tin products, antimony, fats and oil, and petroleum and petroleum products. Russia imported five million barrels of petroleum in 1945 from the United States and 2.5 million barrels in 1946, but in the first half of 1947 these shipments dropped to 730,000 barrels. As of October 1, 1947, pig iron, sheet steel, steel plate, and boiler plate came under export control in the United States.

Notable declines in U.S. exports to Russia during 1947 in comparison with the trade for 1946 occurred in meat products, dairy products, vegetables, and copper. Russian imports of consumer goods from the United States dropped to negligible amounts during 1947. U.S.S.R. imports of meat and dairy products from the United States, which had totaled $86 million in 1946, dropped to $4 million in January-November 1947. As a result, machinery accounted for 72 per cent of total Russian imports from the United States for the first 11 months of 1947, in comparison with 42 per cent in 1946.

Interest in U.S. machinery is still evident, although the heavy cost of transportation and the tightening of U.S. export controls during January 1948 may hold these imports to lower levels in 1948.

The following table shows U.S. exports to Russia for 1946 and 11 months of 1947.

U.S. Exports of Selected Commodities to U.S.S.R.
(In millions of dollars)

Commodity	1946	Jan.-Nov. 1947
Electrical machinery	44.1	17.7
Power machinery	36.0	5.4
Construction machinery	5.4	7.4
Mining machinery	13.9	14.0
Metal-working machinery	41.3	21.9
Textile machinery	.7	.8
Other industrial machinery	18.7	21.3
All industrial machinery	116.0	71.8
Agricultural machinery	1.6	2.4
Total machinery	161.6	91.1
Automobiles	3.9	1.6
Aircraft	.3	.3
Other vehicles (including merchant ships)	3.2	3.1
Total machinery and vehicles	169.0	96.1
Steel mill manufactures	14.6	14.4
Petroleum and products	6.0	2.7
Copper	5.6	.5
Meat products	69.1	3.2
Dairy products	16.9	.5
Vegetables and products	7.3	none
Leather manufactures	5.2	none
Miscellaneous (including relief)	12.0	3.1
Total	357.9	133.1