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THE ARGENTINE-SWISS TRADE AGREEMENT

Ernest C. Olson

The Argentine Government recently suspended all Argentine exports to Switzerland. No official explanation was offered but it is quite evident that Swiss resistance to Argentine demands in connection with their Trade and Payments Agreement inspired Argentina to take this drastic step. A review of Argentina's behavior under the agreement reveals signs of a growing foreign exchange crisis and perhaps foreshadows the manner in which other agreements to which Argentina is a party will be treated. Commercial relations under the agreement have been marked by three phases: (1) the original agreement, (2) the revision of August 1947, and (3) Argentina's recent export embargo. A discussion of each of these phases is presented below.

The agreement was signed in Buenos Aires on January 20, 1947, and was to continue in effect through the end of 1951. Argentina agreed to deliver specified quantities of various grains and oils and, insofar as her obligations to other nations would permit, meat and dairy products as well.

In return, Switzerland agreed to supply industrial machinery (excluding machinery for making watches), electrical equipment, and other manufactures. Payments were to be effected on a compensation basis through the central banks of the two countries. Any balance outstanding at the time the agreement expires was to be settled by the transfer of merchandise, or by payment in Swiss francs, Argentine pesos, other exchange, or gold.

It was anticipated by both parties that under this arrangement their expenditures and receipts would tend to balance and the traditional Swiss trade deficit with Argentina would be offset by Argentine financial transfers to Switzerland. All such transfers were to be made in Swiss francs. Since Switzerland supplied Argentina with large franc payments in covering its trade deficit, there seemed little doubt that Argentina would be able to remit francs in making financial transfers to Switzerland.

Differences in interpretation of Article 17 concerning such transfers appeared almost immediately and continued for a period of several months. Argentina insisted that francs received in payment for exports to Switzerland were needed urgently for other purposes and accordingly refused to make franc remittances to Switzerland covering financial payments. The situation was further complicated by Argentina's refusal to sell foodstuffs to Switzerland at world market prices. Although the agreement assured Switzerland the right to buy elsewhere at a lower price, such supplies were unobtainable during the first quarter of 1947 and Switzerland was obliged to pay the excessively high prices demanded by the Argentine Institute for the Promotion of Trade. During the second and third quarters of 1947, Switzerland purchased no wheat from Argentina, thus reducing Argentina's franc earnings and its capacity to make franc payments to Switzerland for invisible imports. Meanwhile, balances owed to Switzerland for interest, dividends, profits, insurance premiums, licenses, patent fees, royalties, etc., mounted.

In an attempt to make the agreement effective, the Central Bank of Argentina and the National Bank of Switzerland on August 20, 1947, entered into a supplementary agreement intended to facilitate financial payments to Switzerland. The National Bank of Switzerland made available to the Central Bank of Argentina overdraft facilities not to exceed 40 million francs in any three-month interval, subject to prompt settlement in Swiss francs or gold at the end of each quarter year. Francs advanced under this credit were to be used exclusively for making payments in Switzerland.

By the time this supplementary agreement was reached, the decline in Argentine gold and foreign exchange resources since the end of the war had reached serious proportions. Despite the commitment of both signatories to make every effort to increase their trade with each other, Argentina was obliged last September to impose new restrictions on imports, discriminating against commodities which it considered luxuries, among which were Swiss watches. Swiss exports to Argentina, already substantially below imports, were thus reduced, causing the Argentine franc balance in the National Bank of Switzerland to increase. Nevertheless, the previously experienced transfer difficulties seemed to be resolved and throughout this period there had been a franc balance in favor of Argentina. The relief, however, was apparent rather than real, because the Argentine Central Bank did not fulfill its commitment to effect prompt payment of financial transfers. A typical case of delayed payment is that of the Compania Italo Argentina de Electricidad S.A.

More than half of the capital investment in this company is owned by Swiss nationals. Swiss holders of dividend coupons were obliged to wait four months for franc remittances due last October, and as of last month had received only blocked peso balances for the dividend due in April 1947. Amounts owed to Swiss shareholders for the dividend which fell due last April were again paid into blocked accounts.

The attitude of Argentina since the original agreement was signed seems to have been at some variance with the announced purpose of the agreement which was to expand trade between the parties and to facilitate Argentine financial transfers to Switzerland. By reducing imports from Switzerland and obstructing financial payments Argentina has accumulated a considerable franc balance which last month was estimated to be equivalent to \$49 million. Interpreting the supplementary agreement to its own advantage, the Central Bank of Argentina demanded that the entire franc balance at the National Bank of Switzerland be converted forthwith into dollars. Inasmuch as the Swiss are under no legal obligation to convert this balance before 1951, they did not yield to this peremptory demand and the Argentine Government stopped all exports to Switzerland, ostensibly to prevent further accumulation of francs. Had Switzerland acceded, Argentina in the future would have been encouraged to resort to every means at its disposal to maximize its franc balances for current conversion into dollars.

There can be little doubt that the drain on Argentina's gold and foreign exchange resources during recent months has been a factor in influencing Argentine behavior under this agreement. Net holdings of the Central Bank reached an all-time high in September 1946 when they were estimated to be \$1,769 million, but declined precipitously during the past year. At the end of April of this year, they were estimated to be only \$824 million. Of this amount it is believed only \$234 million was in gold and approximately \$115 million in hard currencies although imports last year were probably unnecessarily high. The 1947 balance of trade deficit with the United States, \$538 million, was about one and one-half times the sum of present gold and hard currency holdings. The fact that Argentina had to sell extensively on credit extended chiefly to European countries or for inconvertible currencies while purchasing in hard currency markets, has undoubtedly contributed significantly to the depletion of its reserves.

Recent statements by Argentine officials indicate that Argentina is counting heavily on off-shore purchases under the European Recovery Program to meet its dollar requirements. The extent of this assistance will be determined by negotiations with the Economic Cooperation Administration, but if dollar availabilities should not be deemed adequate by the Argentine Government it is possible that Argentina may very well attempt to exact payment in dollars for credits outstanding under existing agreements with other countries. On the other hand, confronted with a somewhat improved world food supply and a world-wide need for dollars, Argentina may prove to be a less formidable negotiation in the future.

There can be little question that it is to Argentina's advantage to remain on good terms with Switzerland in view of the mutually beneficial commercial relations the countries have enjoyed in the past. The present situation serves to emphasize the difficulties Argentina faces in becoming a creditor nation at a time when it has balance of payments surpluses with areas which are unable to supply its needs and a deficit with its chief supplier, the United States.

INDUSTRIAL PRODUCTION IN THE ERP COUNTRIES

Randall Hinshaw

In its recent excellent survey of the European economic situation, the United Nations Economic Commission for Europe published a composite index of industrial production covering fifteen European countries.^{1/} This index, which includes countries on both sides of the Iron Curtain, is on a 1938 base, and has thus far been carried through seven quarters, ending with the third quarter of 1947. Enough time has now elapsed since the preparation of the index to add a fairly solid figure for the fourth quarter of 1947 and a provisional figure for the first quarter of 1948. Accordingly, the writer has attempted to bring the index up to date and at the same time to make certain modifications.

The following index of European industrial production differs from the United Nations index in two respects: (1) it includes only ERP countries, and (2) it makes use of new or revised production series for Italy, Sweden, and the United Kingdom. The new index covers nine countries: Belgium, Denmark, France, Germany, Italy, the Netherlands, Norway, Sweden, and the United Kingdom. According to the Economic Commission for Europe, these nine countries in 1938 accounted for 69 per cent of all European industrial production outside the U.S.S.R. Like the United Nations index, the index below is on a 1938 base, and the component production series are combined on the basis of their relative share in European production in the base year.

In order to make possible continuation of the composite index on a convenient and consistent basis, each of the component series, except in the British and Italian cases, was taken directly from the United Nations Monthly Bulletin of Statistics. When the Economic Commission for Europe was preparing its survey, no satisfactory index of British industrial production was available for the postwar period. Consequently, the Commission constructed its own index. Recently, a new official British index of industrial production has been released, and this has been substituted in the table below for the series used by the Commission.^{2/} Since the official index has been extended back only to the beginning of 1946, it was necessary to relate the series in some way to the prewar base. This was done by making use of the Commission's estimate of the percentage change in British production from 1938 to 1946. According to the Commission, industrial production in the United Kingdom was 4.6 per cent higher in 1946 than in 1938; accordingly, the official British index, which is on a 1946 base, was inflated throughout by this percentage.

The Italian series which appears below is a modification of the series compiled by the Italian Federation of Industry.^{3/} There is evidence that the latter index, which covers only large-scale business, seriously underestimates the present level of Italian production as compared with the prewar period. According to an independent estimate by the Bank of Italy,

^{1/} Economic Commission for Europe, A Survey of the Economic Situation and Prospects of Europe, United Nations, Geneva, 1948, Table 1, p. 3.

^{2/} The new British series was taken from the British Monthly Digest of Statistics.

^{3/} The original series appears in Notiziario della Confederazione Generale dell' Industria Italiana.

The Level of Industrial Production in ERP Countries
(1938 = 100)

	Per Cent of European Production in 1938	1946				1947				1948
		First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter
Belgium	3:24	77.8	84.8	90.1	99.1	100.0	107.8	100.9	113.2	113.6 ^{a/}
Denmark	1.61	99.0	93.7	104.0	108.0	108.3	107.7	114.0	118.3	124.0
France	10:80	67.3	82.7	77.0	89.7	93.0	100.3	91.3	95.7	109.0
Western Germany ^{b/}	16:62	27.7	31.7	36.7	36.0	30.0	38.3	41.7	43.3	44.0 ^{c/}
Italy	7:24	42.9	69.4	82.0	77.0	62.2	80.4	90.0	85.8	79.5
Netherlands	3.12	61.4	68.3	75.9	88.1	83.9	89.1	91.1	105.2	101.2
Norway	0:94	92.7	103.3	94.7	110.0	113.3	119.0	106.3	120.0	125.7
Sweden	3:56	134.1	135.8	133.2	136.7	136.2	138.0	136.7	137.1	140.1
United Kingdom	21.62	98.3	102.5	103.2	114.0	100.8	115.4	114.7	125.9	126.6
Composite Indexes										
Inc. Germany	68.75	69.6	78.0	80.4	86.4	79.5	90.5	90.3	95.5	97.6
Excl. Germany	52.13	82.9	92.8	94.3	102.5	95.3	107.2	105.8	112.2	114.6

^{a/} January-February rate.

^{b/} The weighting for Germany is on the basis of all three Western zones, while the production index is based only on the British and U.S. zones. In the absence of a French index, it is here assumed that relative movements in French-zone production correspond to those in the other two zones.

^{c/} January rate.

Italian industrial production for the year 1947 was at 79.6 per cent of the 1938 level.^{1/} Since there is reason to believe that the latter figure is more indicative of the true situation, the monthly series published by the Federation of Industry has been inflated by the percentage required to yield a monthly average, for 1947, of 79.6. The quarterly series was then derived from the monthly figures.

A similar adjustment was made in the case of the Swedish index of industrial production. The latter index is an unofficial series which, under present conditions, is believed to underestimate by a wide margin the current level of Swedish production in relation to the level before the war. Fortunately, annual official figures, derived from industrial census data, are available which make possible a reliable comparison of the postwar and pre-war periods.^{2/} On this basis, industrial production in 1946 was 35.0 per cent higher than in 1938. Accordingly, the unofficial Swedish index, in which the monthly average for 1946 is only 10.3 per cent above 1938, was inflated by the proportion required to yield a monthly average, for 1946, of 135.0.

Except in the Danish and Swedish cases, the component series are unadjusted for seasonal variation. The combined weight of the Danish and Swedish series is only 7.5 per cent of the total in the base year.

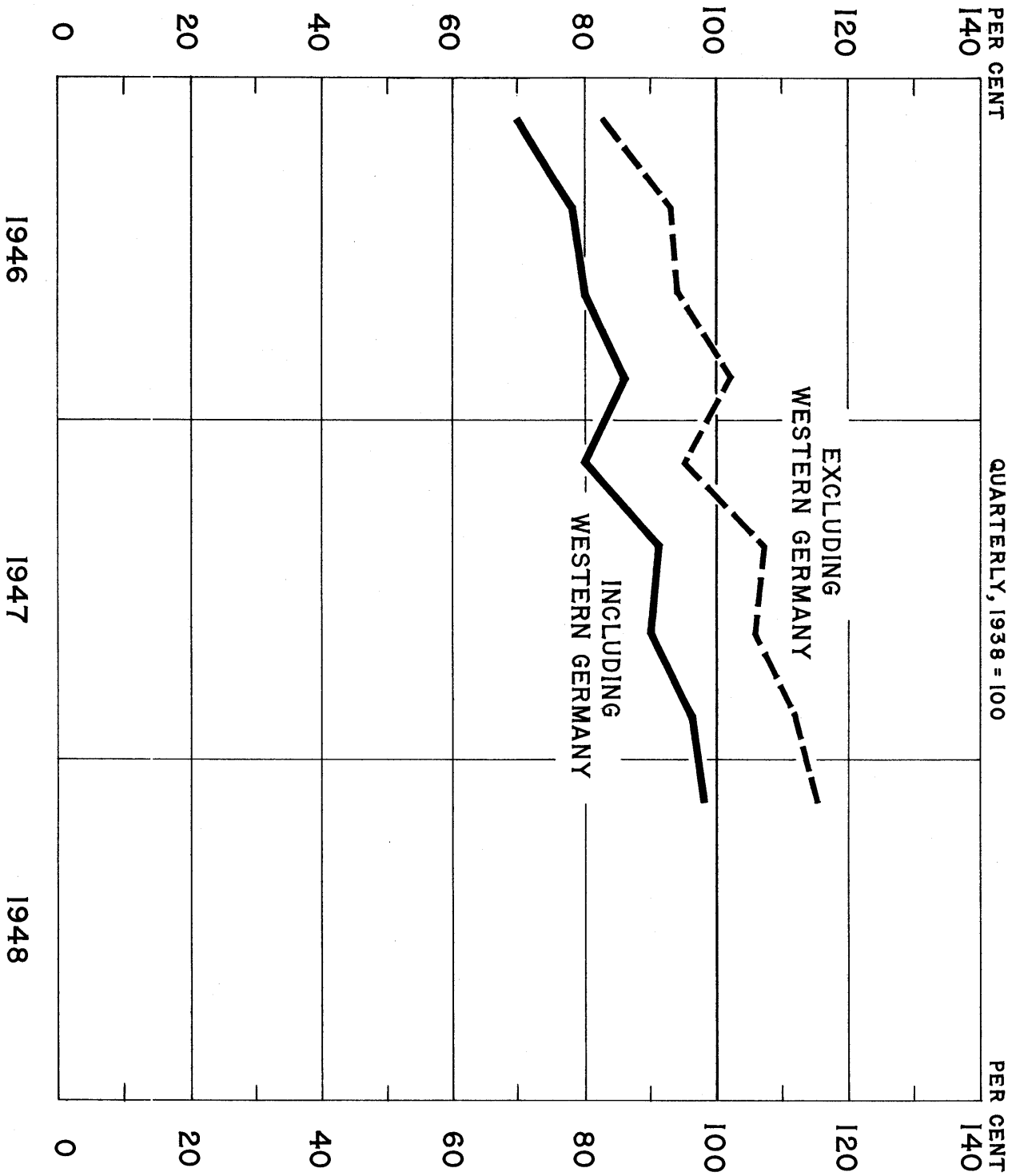
The table shows the various component series and two composite indexes--one including, and the other excluding, Germany. All series are on a 1938 base. The first column shows the percentage contribution of each country to European production in 1938, as estimated by the Economic Commission for Europe. These percentages were used as fixed weights in constructing the composite indexes. The composite series were derived simply by multiplying the component indexes by the respective weights and expressing the totals as percentages of the total for the base year. The two composite indexes are shown in the chart on the following page.

Even after due allowance is made for such factors as the limited reliability of some of the component series and the more or less general deterioration in quality of output, the recovery of European production, as shown in the foregoing table, is truly remarkable. According to the figures, industrial production in all the included countries except Germany and Italy was above--and in several cases much above--the prewar level. The most spectacular increases are recorded in the case of the Scandinavian countries and the United Kingdom. According to the composite series, the industrial production of the entire group of countries rose from 70 per cent of the 1938 level in the first quarter of 1946 to 98 per cent in the first quarter of 1948. With Western Germany excluded from the group, industrial production in the first quarter of 1948 was actually 15 per cent higher than in 1938, and was 38 per cent higher than in the first quarter of 1946. The setback in production in the first quarter of 1947, which received so much attention in the discussions of a year ago, is clearly shown in the composite indexes, but the ground lost at that time has long since been recovered.

^{1/} Annual Report of the Bank of Italy, 1947. There is no direct way of comparing the Bank's figure with the Federation index, since the latter is on a 1939 base, with no figure for 1938. On its own base, the Federation monthly average for 1947 is 63.1.

^{2/} K. G. Nilsson, "Den industriella produktionens volym i Sverige 1945 jämte preliminära uppgifter för 1946", Kommersiella meddelanden, November 1947.

INDUSTRIAL PRODUCTION OF ERP COUNTRIES



SOME CENTRAL BANKING PROBLEMS IN INFLATIONARY CHINA

John Exter

It is unfortunate for the prestige of the Central Bank of China that the establishment of the Bank was followed so closely by serious monetary difficulties. China left the silver standard and established a managed currency system in November 1935, and the charter of the Central Bank was promulgated in the following January. These dates did not much precede the beginning of what have become China's chronic currency troubles. The man on the street also notes that the period of acute inflation has come since 1942, when the Central Bank of China was given the monopoly right of note issue. There is thus a superficial plausibility to an explanation of the Chinese inflation which relates that inflation in general to the establishment of the Central Bank, and in particular to the grant of the exclusive privilege of note issue.

More sophisticated observers will point out, of course, that the basic cause of the hyperinflation in China is the tremendous over-issue of paper money and that paper money was invented long before central banks. The overriding needs of the State to finance both the war with Japan and the war against the Communists would have resulted in excess currency issues whether the Central Bank had existed or not. Moreover, China actually did not have a real central banking system in the accepted sense of the term when the present inflation and currency depreciation began. The Central Bank did not become the sole bank of issue until 1942, and it does not even today have most of those powers over the banking and currency system which have generally been granted to central banks elsewhere. The present charter of the Central Bank of China was regarded from the very beginning as a stopgap affair. As early as June of 1936, a much more thoroughgoing charter was drawn up and presented to the Minister of Finance. It provided for a central bank of the more traditional type, with much more control over the credit operations of the banks than the present Central Bank has ever had. Before the new charter could be adopted and put into effect, however, the war with Japan began, and it was decided to postpone fundamental monetary and banking reform until after the emergency. It could not have been foreseen, of course, that the emergency would be so serious nor that it would last so long. In any case, the decision was undoubtedly a wise one; conditions in China have made impossible the exercise of normal monetary policy. The present Central Bank has had to resort to the printing press on a large scale, and, although a good charter would have enabled it to exercise greater authority, it is evident that the Bank could have retarded the increase in the money supply only to a very moderate degree. Nevertheless, it is interesting to note that, even with conditions as chaotic as they are at present, the Central Bank is continuing the struggle to acquire the degree of control over credit which it considers properly belongs to it. Before discussing the most recent developments in this struggle, it will be necessary to describe briefly the nature of the Chinese banking system.

Unfortunately for purposes of devising adequate means of control, the banking system in China is a complex one. Apart from the Central Bank, there are three principal groups of banks: the modern-style government and private banks, the old native-style banks which differ from Western-type banks in their organization and use of banking instruments, and the foreign banks.

Of the modern-style banks, six National Government banks hold a dominant position in the Chinese economy:

- (1) The Bank of China, which concentrates primarily on financing foreign trade but which also makes industrial and commercial loans;
- (2) The Bank of Communications, whose primary interest is financing transportation, industry, and mining;
- (3) The Farmers' Bank, whose primary interest is making agricultural loans;
- (4) The Postal Remittances and Savings Bank, which was originally organized to handle savings and remittances, but which also does a general banking business;
- (5) The Central Trust, which, as a subsidiary of the Central Bank has been specially commissioned to write various types of insurance and to act as government purchasing agent; and
- (6) The Central Cooperative Bank, which was organized as a central bank for agricultural and industrial co-operatives.

In addition to the banks organized by the National Government, there are modern-style banks established by the provincial and hsien (county) authorities. There are also a large number of modern-style private banks, most of which have their head offices in Shanghai.

The native-style banks decreased considerably in number and relative importance during the decade before the war, but their growth has been stimulated again by the war and the inflation. They are privately-owned individual proprietorships or partnerships and operate with little or no government control. Some of the long-established native-style banks are older than any other banks in China and wield considerable influence.

Most foreign banks in China are branches of large American, British, Dutch, and Belgian banks which are interested in financing foreign trade.

The controls which the Central Bank has been able to exercise over the credit operations of the various types of banks have been extremely tenuous. As already indicated, the native-style banks operate virtually uncontrolled. The modern-style private banks have been subject to a fixed 20 per cent reserve requirement, but otherwise have operated quite free of central control. They have not had access to Central Bank credit, so that the rediscount rate, one of the traditional instruments of central bank credit control, has not affected them directly. The National Government banks, on the other hand, have not had a minimum reserve requirement, but have enjoyed rediscount privileges. Theoretically, therefore, their operations should have been subject to the control of the Central Bank. Because of the extremely narrow limits of their own resources, they have had to be assured that advances from the Central Bank would be forthcoming before they could make any loans

of significant size. Unfortunately, however, the Central Bank has had very ineffective control over its own credit operations.

All important loans have had to be approved, not by the Central Bank, but by the Council of the Joint Head Office in Nanking, the Chairman of which is Generalissimo Chiang Kai-shek himself. This Council was formed to appease the majority of the banks which did not want too much power to be centralized in the hands of the Central Bank. There are fifteen members in all, including not only representatives of all of the government banks but also five cabinet members who are concerned with economic problems. In practice, the Council has proved to be too cumbersome a body, so that a loan committee of seven members was established. This committee was composed of the Governor of the Central Bank as Chairman and one representative from each of the six other government banks. It not only determined whether the bank making the loan could rediscount it with the Central Bank, but also fixed the interest and rediscount rates, and the amount. The possibilities for abuse in such a system are all too obvious. Clearly, in a committee composed of six borrowers with the only lender as chairman, no one of the borrowers would oppose the application of any other borrower for fear that his own application might subsequently be treated unfavorably. Against the combined forces of the six borrowers, the Central Bank as the only lender stood alone.

To make matters worse, there has been heavy pressure on the Central Bank to keep its rediscount rates artificially low. This has been particularly true of loans to government agencies, which are most commonly the original borrowers. The Central Bank's rate has ordinarily been about 5 per cent per year. The extreme artificiality of this rate can be appreciated when it is compared with the legal maximum rate for short-term loans of 24 per cent per month, and with recent black market rates of 30 to 40 per cent per month. Not only has this system proved extremely slow and cumbersome, but it has deprived the Central Bank of an effective voice in its own credit policy.

Governor Chang Kia-Gnau, who recently resigned in favor of O.K. Yui as Governor of the Central Bank, was able to gain acceptance for a system of approving loans which puts considerably more control in the hands of the Central Bank. This system is now in the process of being implemented. Under it the Central Bank will be able to make advances to private commercial banks, as well as to the government banks, and can do so without going through the Council of the Joint Head Office. The Council will still be retained, but only to pass upon loans by government banks to government agencies. The Loan Committee is to be abolished. To do the work of the Loan Committee, the Governor of the Central Bank has appointed a Discount Committee of the Central Bank in Shanghai which will determine the credit policy of the Bank and pass on loan applications. Although the members of this committee will come primarily from outside the Central Bank, they will serve at the pleasure of the Governor of the Central Bank. The present plan calls for a committee of nine members with the Governor of the Central Bank as chairman and the Deputy Governor and the Chief of the Banking Department as members. The other members are an officer of the Bank of China, another of the Bank of Communications, the President of the Shanghai Chamber of Commerce, the President of the Shanghai Banker's Association, the Chief of the Currency Division of the Ministry of Finance, and the Secretary General of the Council of the Joint Head Office. Each of these members serves as an individual, and not as a representative of the organization by which he is employed. The Governor may, at his discretion, increase the size of the committee to fifteen.

There are to be three advisory committees of a technical character: one on agriculture, another on industry and mining, and a third on trade. Each of these committees will process applications within its competence and make recommendations to the Discount Committee.

Proposed loans by government banks to government agencies will henceforth go to the Council through the Central Bank's Discount Committee rather than through the Council's own Loan Committee. Since loans submitted to the Council will carry the recommendations of the Committee, the Central Bank will have somewhat more influence on the decisions of the Council of the Joint Head Office than it has had before.

Although the establishment of the Discount Committee in Shanghai is not a revolutionary step, it will strengthen the hand of the Central Bank in resisting the political pressures in Nanking. The granting of discount privileges to the private banks, while eminently reasonable in ordinary times, may at this time create more problems than it solves. The private banks have very much resented the fact that they have been denied access to central bank credit and they will undoubtedly ask for their fair share and exert a pressure which will be difficult for the Central Bank to resist.

This pressure is particularly important because it has its roots in one of the anomalies of Chinese banking today: relative to the volume of currency, banks have very few deposits. They therefore find themselves with negligible lending capacity in terms of the present purchasing power of money, and they are forced to get advances from the Central Bank if they are to make any loans at all of significant size. Otherwise, they would face a loss of cash which they would be unable to meet. The explanation of the lack of deposits is, of course, that the public is unwilling to hold money in any form. People spend their incomes as fast as they get them; bank accounts are held to the absolute minimum. As might be expected, the turnover of the reduced volume of deposits is exceedingly high.

The lack of lending capacity on the part of the commercial banks means that control of central bank credit policy is relatively more important than in a more normal economy. If for no other reason, the recent developments in Chinese central banking are very significant. Although the new Discount Committee system promises to place more and more responsibility for private credit policy with the Central Bank, the all-important public credit policy will, of course, remain in Nanking with the Council of the Joint Head Office. It is hardly to be expected that a government engaged in civil war could do otherwise.

The Chinese Government may go still farther in the direction of giving the Central Bank greater authority in monetary matters. A set of legislative principles for a revised charter of the Central Bank was recently placed before the Legislative Yuan, but was later withdrawn, apparently on account of pressure from the Central Bank itself, which thought that the principles did not incorporate enough of the latest developments in central banking theory and technique. It is now quite possible that a new Chinese central bank charter, when and if it comes, may be more closely related to the recent Latin American and Philippine legislation than to the more traditional type of legislation as represented by the draft charter of 1936. In any case, it is probable that central banking reform will be deferred until economic conditions are more favorable, so that, whatever the precise nature of the reform, the bank may have a fair chance to succeed and to make a proper place for itself in the economic life of the nation.