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

REVIEW OF FOREIGN DEVELOPMENTS

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CURRENCY REFORM IN GERMANY

J. Herbert Furth

In the period between June 18 and June 26, 1948, the occupying powers announced a series of laws enacting the long-awaited monetary reform in the U.S.-U.K. and French zones of Germany. On June 23, the USSR occupation authorities promulgated a currency reform for the Eastern zone, including all of Berlin. The same day the Western occupation authorities declared the USSR order "null and void" in regard to the Western sectors of Berlin, and extended the Western currency reform to these sectors.^{1/}

1. Currency Reform in Western Germany

The Western powers introduced a new currency, called the Deutsche Mark (German mark), divided into 100 pfennig. In the name of the new currency the word Reich thus has been replaced by the word Deutsche. The currency is issued by the Bank of German States,^{2/} of which all central banks in the States of the three Western zones have become members.

^{1/} The full text of the laws was not available at the time of the writing of this paper; the following discussion therefore is based upon condensed reports.

^{2/} See this Review, March 9, 1948.

In general, ten old marks are exchanged for one new mark. At the time of the exchange, however, holders were entitled to receive only 60 new marks per head (40 marks immediately and another 20 marks within a month), while all bank notes in excess of that minimum had to be deposited. These deposits, as well as deposits on old accounts, will be cleared for conversion after an investigation into the state of the holders' tax accounts and into the method by which the money was acquired. Only deposits not exceeding 5,000 old marks (in the case of tradesmen and professional people, 10,000 marks) can be cleared without investigation. Enterprises received immediately 60 new marks per employee for wage and salary payments, and can apply for provisional clearances of their entire deposits in order to avoid interruption of business.

One-half of the amount of the converted deposits will be blocked until further notice. Under regulations to be issued after consultation with the German authorities, the holders may at some future time be permitted to apply for further payments up to a maximum not exceeding the amount originally converted. Coins and notes of one reichsmark and less remain temporarily in circulation at one-tenth their face value.

Funds of public agencies will not be converted, but public agencies will receive funds in new currency equal to the amount necessary for their operations for one month. The accounts of the occupying powers are treated exactly like the accounts of German public agencies.

Debts contracted before June 19, 1948, are converted at a ratio of 10 to 1. Wages, salaries, rentals, annuities, pensions, and similar recurring payments, however, are converted at the rate of 1 to 1. Special provisions deal with the problems of insurance contracts and other contracts that remained unfulfilled at the time of the reform. A moratorium on all debts was issued for the period of conversion; the courts may grant further moratoria for debts with the exception of wages and salaries, if the debtor cannot reasonably be expected to make payment immediately. All Reich securities are completely canceled; other bonds are converted at the rate of 10 to 1.

Special levies will be enacted before the end of the year to provide means for the equalization of hardship cases; these levies will include a severe tax upon increments in the value of property during the war and post-war period. The only tax provisions enacted so far provide for a limited tax reform. Income tax rates are reduced by an average of one-third, but a rate of 95 per cent for incomes over 250,000 marks has been retained. The corporation tax and the annual tax on property are simplified and their rates reduced. On the other hand, the tax on capital transactions and negotiable instruments is increased by 50 per cent, and a new duty on coffee amounting to 30 marks per kilogram is introduced.

The old military rate of 10 marks per dollar, which had lost most of its practical importance,^{1/} finally has been formally abolished. The only effect of this change will be felt by German employees of American agencies, who have been paid on the basis of a dollar scale, converted into German currency at the military rate. In order to avoid hardship, the dollar basis of their payments will have to be increased if the general conversion factor

^{1/} See this Review, April 20, 1948.

of 30 cents per mark--which now remains the only rate in existence--is to be applied to their salaries. This conversion factor still has not received the title and dignity of an exchange rate. A formal exchange rate will be proclaimed only after the effect of the currency conversion on the German wage and price level has been observed. Apart from the name, however, there is little to distinguish that conversion factor from a provisional exchange rate.

2. Currency Reform in Eastern Germany

The currency reform sponsored by the Soviet occupation authorities resembles closely the Western model. The conversion factor also is 10 to 1, with the difference that (a) holders receive immediately 70 rather than 60 new marks; (b) savings deposits are converted at the rate of 1 to 1 up to 100 marks, and 5 to 1 up to 1,000 marks; (c) accounts of public agencies (including the occupation authorities, socialized enterprises, and the organizations affiliated with the Socialist Unity Party) are converted at the rate of 1 to 1, and accounts of certain farm associations at the rate of 5 to 1; (d) coins continue to circulate at their face value; (e) no new notes were issued but coupons were affixed to the old ones; and (f) no tax reform program seems to have been announced or enacted.

Of all these differences, only the treatment of public accounts needs further consideration. In the Western zones, the public agencies, including those of the occupying powers, receive less than their previous share of the currency in circulation, while in the East they receive considerably more. Actually, however, this difference is less important than it seems. Even without preferential conversion provisions, the occupation authorities in the East would have diverted a very substantial part of the total money supply into their accounts since they control the revenues of the Sovietized enterprises and claim the greater part of the proceeds of the heavy taxes levied upon the German sector of the economy. In the Western zones, the occupation authorities will accumulate substantial amounts of money in a very different way and for very different purposes: these zones receive imports under the European Recovery Program and the agreements between the U.S. and U.K. Governments, which may total \$1.2 billion in the fiscal year 1948-49. Payment in foreign currency for these imports has been deferred, but the equivalent in German currency is to be deposited into special accounts, controlled by the occupation authorities and the Economic Cooperation Administration. These balances will give the occupying powers ample control over the money supply in Western Germany, quite apart from the supervision over the bank of issue, exercised by the tripartite Banking Commission. It is possible, however, that the difference in the treatment of public accounts will impart an inflationary tendency to the Eastern and a deflationary to the Western zones.

The failure of the occupying powers to enact a uniform currency reform was due to political, rather than economic and financial, differences of opinion. Should the political problems be settled, the reunification of the currency would be a relatively easy task.

3. The Problem of Berlin

The failure of a uniform currency reform is being felt most heavily in Berlin. The Western powers originally did not introduce their currency in Berlin since that city economically has closer ties with the Eastern rather than Western zones of occupation; moreover, any Western currency introduced in Berlin might find its way into hands that could use it to the detriment of the economy of the Western zones. The Soviet authorities, however, attempted to forbid the importation and acceptance of the Deutsche Mark, and to introduce their own currency also in the Western sectors of Berlin, thus proclaiming their authority over the entire city. This unilateral action forced the Western powers as a matter of principle to introduce the Deutsche Mark in the Western sectors of Berlin. The Western powers decreed, however, that the currency of the Eastern zone be accepted in payment within certain limits and, according to the latest reports, that the greater part of wage payments be made in Eastern currency. Thus it may be expected that only small amounts of Western currency will circulate in Berlin. Such a situation need not result in great difficulties: before the war it was customary in many border cities to have two currencies circulating freely side by side. As long as the amount of Western currency circulating in Berlin is limited, the danger of leakage into unwanted hands is not serious, and any attempt to buy up the Western currency would result in a premium which for reasons of prestige should be unwelcome to the Soviet authorities. 1/

The only serious drawback may be an increase in the difficulties of trade between the Western zones and the Western sectors of Berlin. Exports from Berlin may not be hurt since exporters probably will welcome payment in Western currency. Imports into Berlin, however, may be hampered if payment has to be made in Western currency which may become scarce in Berlin. There might be two ways for obviating that difficulty: one would be the establishment of a clearing system, which would effectively prevent the disappearance of the proceeds of Berlin exports into the hands of persons unwilling to use them in payment for imports. The other would be the creation of a special currency for the Western sectors of Berlin, say, by stamping Deutsche Marks imported into Berlin. This Berlin currency would be accepted in payment for Western zone exports to Berlin, but otherwise could not be shipped back to the Western zones without a special license. Such a currency would be of little interest to persons that did not want to use it for commercial transactions with the Western zones.

4. Effects of the Currency Reform

It is expected that the currency reform will have the usual consequences: a sharp drop in black market prices and activities; an easing in the manpower situation, with former black marketeers looking for productive employment; an increase in the supply of goods for export and for domestic consumption through legal channels; and finally, a recession in passenger traffic (which hitherto consisted largely of black marketeers) and luxury trades. In the longer run, the decrease in money supply may make necessary a revision of fiscal and credit policy from anti-inflationary to anti-deflationary measures.

1/ An ordinance of July 4 provides for the Berlin reform to deviate in some details from the laws for the Western zones and to be technically more similar to the procedure followed in the Eastern zone.

Some of these effects are already being felt in Western Germany. Black market prices are reported to have dropped by as much as 90 per cent, a few of them falling below the legal price level. The increase in imports resulting from the inauguration of a long-range import program by the Joint Export-Import Agency and especially from the European Recovery Program,^{1/} will assure opportunities for a sharp increase in economic activities and thus counteract the deflationary effects of the disappearance of overliquidity.

The cancellation of Reich securities will have a more restricted effect than such a move would have in any other country. According to the principles of Nazi finance, Reich securities were purchased mainly by insurance and credit institutions; the public at large thus is not directly affected. Insolvency of insurance institutions will be avoided by relatively modest public expenditures: ordinary insurance activities will rise considerably after the re-establishment of monetary stability, and the lost premium reserves can be rebuilt out of profits resulting from new business.

The position of the credit institutions will be more difficult. The following table shows bank assets and liabilities in Western Germany as of September 30, 1947 (latest date available); the situation probably did not change much during the intervening period.

Bank Assets and Liabilities, Western Germany,
September 30, 1947
(In billions of reichsmarks)

<u>Assets</u>		<u>Liabilities</u>	
Cash	16.5	Interbank deposits ^{a/}	74.9
Claims against banks	89.0 ^{a/}	Other current deposits	56.2
Reich securities	75.0	Savings deposits	63.3
Other securities	2.4	Loans	7.7
Bills and advances	22.1	Other liabilities	12.0
Other assets	<u>12.9</u>	Capital	<u>3.8</u>
Total	217.9	Total	217.9

^{a/} Including claims and debts in relation to head offices and affiliated branches.

Source: OMGUS Report, Statistical Annex, February 1948.

Detailed figures for the American and French zones show that about one-half of "other" current deposits are on government account. The banks thus will be freed from about 28 billion old marks of liabilities, while losing 75 billion old marks in Reich securities. The resulting deficit of about 47 billion old marks or 4.7 billion new marks will have to be made good by some kind of government guarantee if public confidence in the banking system is to be maintained.

Before the currency reform, currency circulating in the Western zones outside of banks was estimated at 22 billion reichsmarks, which is probably on the low side. An amount of 60 new marks per head will mean a

^{1/} See this Review, March 23, 1948.

currency circulation of 3 billion new marks. In addition, the sums put at the disposition of enterprises and public agencies are estimated at 2 billion new marks, making for total cash in circulation of 5 billion. This would be one-half of the maximum issue covered by the present authorization of the Bank of German States. Owners of current deposits (excluding interbank deposits and public accounts of an estimated 28 billion old marks) would hold about 2.8 billion new marks, and owners of savings deposits about 6.3 billion, making a total of about 9 billion new marks; half of that amount would be temporarily blocked.

At the end of 1938, "Greater Germany" had a currency circulation of 10.4 billion, current deposits (excluding interbank deposits) of 20.7 billion, and savings deposits of 24.4 billion reichsmarks. It is estimated that about 60 per cent of these amounts was available to the territory of the present Western zones of occupation. Since the end of 1938, the legal price level has increased by about 30 per cent and some further increases are being contemplated. Economic activity at present probably is not much higher than 50 per cent of 1938, but a rise to at least 60 per cent is expected for the near future. On this basis,^{1/} the amount of means of payment in circulation (apart from savings deposits) required throughout Western Germany may be estimated at around 5.5 billion in cash and 11 billion in current deposits. Comparing these figures with the present circulation, it appears that the amount of cash may be about sufficient, but that demand deposits may have to be increased almost 300 per cent in order to avoid tightness in the money supply.

In this connection the importance of the "local currency" accounts under the Economic Cooperation Act again becomes obvious. These accounts may well receive deposits amounting to as much as 4 billion reichsmarks in the fiscal year 1948-49, or 80 per cent of the present amount of cash in circulation. On the basis of the preceding calculations, and assuming no new inflationary threats, it would seem advisable not to withdraw these amounts from circulation but, on the contrary, to use them actively for purposes of reconstruction and development.

The problem of Berlin apart, the split between the Western and Eastern currency will have little economic importance. Merchandise trade between the West and the East has been carried out on a basis of bilateral clearing, and no significant change is needed to adapt the clearing system to the new currencies. Passenger traffic has been hampered by so many difficulties that the new obstacle will not make much difference. The political significance of the move, however, may dwarf all economic aspects of the currency reform.

^{1/} Price changes would raise the money supply required at present to about 145 per cent of the estimated 1938 money supply in the area of the present Western zones; the decline in economic activity, however, would reduce that sum by approximately two-fifths to about 87 per cent of the base period, i.e., around 52 per cent of the 1938 money supply in all of "Greater Germany".

REPAYMENT OF ECA LOANS

Robert Solomon

The Economic Cooperation Act of 1948 directs the Administrator to provide assistance for any participating country "through grants or upon payment in cash, or on credit terms, or on such other terms of payment as he may find appropriate..." The "determination whether or not a participating country should be required to make payment for any assistance and the terms of such payment, if required, shall depend upon the character and purpose of the assistance and upon whether there is reasonable assurance of repayment considering the capacity of such country to make such payments without jeopardizing the accomplishment of the purposes of this title." (underscoring added)

It is the purpose of this paper to discuss some of the factors involved in a judgment as to the ability of a particular ERP country to repay loans granted under the Program. To phrase it differently, what are the factors which must be considered by the National Advisory Council and by the Administrator in determining the amount of assistance to be provided to a participating country on a loan basis? Obviously such an analysis could not yield precise results for the allocation of loans to any particular country. On the other hand, even though numerical exactitude cannot be expected, a long-run analysis of the type here outlined is necessary if the United States wants to minimize the probability of another round of defaults and resultant ill-will. The factors to be discussed would be especially helpful in judging the relative abilities to repay of the individual participating countries. Such a comparison is indeed important because the Congressional authorization and appropriation for the first year of the program require that at least \$1 billion of loans (including guaranties) be allocated among the participating countries if the entire amount authorized is to be used.

An analysis of a particular country's ability to repay a foreign loan in the currency of the creditor involves two distinct problems: (1) the ability of that country to provide a balance of payments surplus out of its productive capacity while still maintaining an adequate standard of living and a satisfactory level of investment; and (2) the ability of the debtor country to dispose of that surplus in exchange for the currency of the creditor. These two problems will be referred to as the "production problem" and the "transfer problem" and for purposes of analysis will be discussed separately. It should be recognized, however, that in practice they are interdependent and cannot be regarded as two distinct operations in the repayment of a loan.

1. The Production Problem

The total output of goods and services or gross national product of the participating countries in question will be utilized for purposes of consumption, government and private investment, and repayment of foreign loans; it will be assumed here that over the period of repayment investment by ERP countries will consist mainly of domestic investment, except for principal payments on foreign loans.

The discussion below will be concerned with the future growth and utilization of gross national product. Although the main components of gross national product will be discussed separately, their mutual interdependence should be emphasized. Thus, for example, a growing volume of total output permits both investment and consumption to increase, but the rate of growth of total output itself depends upon the rate of investment.

It will become evident that in order to appraise a country's future ability to repay, the investigator will have to form an idea of future investment "plans".

(a) Gross National Product

It is assumed that loans during the period of the European Recovery Program will be repaid over a period of at least 25 years with payments beginning after about a five-year period of deferment. On this basis, it would be necessary to attempt to estimate the growth of the gross national product of the country over a period of about 25 years following the completion of the European Recovery Program.

Such an analysis would presumably begin with a comparison of the country's present level of production with that of a "normal" prewar year or period. The factors responsible for the change, if any, would be brought out and the extent to which they appear permanent would be appraised. For example, a country whose present gross national product (in real terms) has been reduced considerably below the prewar level because of destruction or deterioration of productive capacity or because of large-scale liquidation of foreign investments during the war faces a more serious and lasting problem than a country whose present gross national product is relatively low because of inability to acquire needed raw materials or because of financial instability.

The investment plan over the ERP period would be examined with a view toward estimating the extent to which the United States assistance permits an increase in productive capacity to replace what has been lost, either at home or abroad. For countries which find it necessary to substitute increased domestic production for lost overseas income and countries which have to replace or modernize plant and equipment, the European Recovery Program has special importance in making possible a large investment program which would permit a relatively rapid increase in productivity, agricultural and/or industrial.

Thus, the extent to which ERP assistance permits an enlarged productive capacity would be estimated. Then an attempt would be made to estimate the post-ERP trend of productivity on the basis of the enlarged capacity. In rough terms, using prewar growth of productivity and modifying it by knowledge of the planned changes in industrial and agricultural structure, one could project the future growth of real income. Full employment would be assumed, and, at this stage, only ability to produce would be under consideration. The problem of ability to sell exports would have to be taken into account at a later stage of the analysis.

(b) Consumption and Domestic Investment out of
Future Gross National Product

After estimates had been made of the growth of total output of the various countries for a period of about 25 years after the completion of the European Recovery Program, the future use of that output would have to be projected. Consumption and investment needs would have to be studied together, of course. Actually, a certain average level of investment would already have been assumed in projecting the trend of total output. However, the nature and purposes of the investment would require further investigation. It would be important to know in what manner and to what extent the components of future investment might be expected to contribute to productive capacity. The effect on production for export as compared with domestic consumption, public works, housing, etc., would be a relevant consideration. It is this aspect of forecasting ability to repay which is most difficult to analyze because investment plans, either of governments or of private firms, are seldom made over so long a period of time and because there is greater latitude for variation in the character of investment than in the other components of gross national product.

At the same time it would be necessary to set up a standard which could be used to measure the adequacy of the level and composition of consumption. For the essential items of consumption a minimum standard would be worked out, taking into account the standard of living of the past, changes in income distribution, and political developments and expectations. For example, it is likely that the distribution of income in the United Kingdom will remain such that the dispersion of standards of living among the various income classes will remain considerably smaller than it was before the war. Although the standards of the wealthier income classes will probably remain relatively lower than in the past, the lowest standard will be raised permanently. The effect of such changes in income distribution on total consumption requirements would be estimated.

For the less essential consumer goods, a range could be established indicating minimum and maximum levels of total consumption. This would provide a cushion for failure to meet targets and allow a margin for errors of estimation. In addition, the future trend of population, immigration, and emigration would have to be estimated, not only for purposes of estimating consumption but also for projecting the size of the labor force.

With these consumption requirements in mind, the investigator would review the assumptions that had been made with regard to investment, in order to establish consistency between the two sets of assumptions.

Throughout the entire analysis assumptions would be required concerning the future terms of trade of the prospective borrowers. These assumptions would be crucial since they influence the import and export requirements associated with the future trends of production, investment, and consumption. An attempt to project the terms of trade of the ERP countries would involve a consideration of industrialization plans and political developments in primary-producing countries as well as other factors that might affect the future supply of the traditional imports of Western Europe. Such a projection would have to be based on the assumption of a fully employed world economy.

If it were possible to make the estimates outlined above for a period of about 25 years, it would, in turn, be possible to derive estimates of the potential annual balances of payments of the particular countries. Presumably all current payments and receipts would have been taken into account, including interest, dividends, etc., on pre-ERP loans and investments by foreigners.

Then, after account had been taken of obligation to make principal payments on pre-ERP debts to the United States and other countries, it would be possible to form a judgment as to the ability to produce an unobligated export surplus. This type of analysis would be used to indicate how much ECA assistance, if any, might be extended on a loan basis. However, it would still be necessary to determine to what extent the research processes outlined so far should be extended to the consideration of the transfer problem.

It will be noted that no attempt has been made here to link ability to repay with the types of imports which the loans might finance. It is sometimes asserted that imports of capital goods should be financed on a loan basis while imports of raw materials and consumer goods should be on a grant basis. There are too many cases for which this proposition is not valid. For example, a country which is assured of a supply of consumer goods over a four-year period through foreign loans can devote its labor and other resources to building up its productive capacity by producing capital goods domestically. This is especially true in some of the industrial countries of Europe which have well-developed flexible economies. On the other hand, there are cases where even loans which finance the importation of capital goods will not be repayable. This might be true of the United Kingdom, in view of its serious loss of overseas income and deterioration of plant and equipment. For these reasons it is maintained that only a thorough examination of a country's prospects for increasing productivity may properly be the basis for judging ability to repay.

2. The Transfer Problem

The other aspect of the problem of ability to repay, the transfer problem, involves even more uncertainties. Whereas the physical ability to produce an export surplus while maintaining an adequate level of investment and consumption depends to a great extent on the efforts of the borrower, the ability to transfer that surplus into dollars depends also on developments and conditions in other countries, including the United States. Even if it were possible to forecast with a fair degree of accuracy that a prospective borrower could provide an over-all export surplus of a given size, it would not follow automatically that such an export surplus would yield an equivalent amount of dollars.

American loans can be expected to be repaid only if the United States develops a balance-of-payments deficit on current account and/or American capital outflow continues in sufficient volume to permit debt repayment. In other words, repayment can be expected only if dollar payments by the United States on current and capital accounts (including payment for imported gold) are sufficiently large to permit the rest of the world to purchase needed imports and services and still have enough dollars to service the loans.

Whether or not such a situation evolves, depends obviously not only upon the supply of dollars made available to the rest of the world by the United States but also upon the use to which foreign recipients put those dollars. Since the problem under consideration is the ability to repay rather than the exercise of that ability, it may be assumed for the present that foreign recipients of dollars will tend to import only "essentials" from the United States as long as they have dollar debts outstanding.

It would appear that not only the volume of dollar outflow from the United States but also the destination of that flow must be taken into account. To the extent that future U.S. imports from and capital flow to an ERP borrower exceed that country's import requirements from the United States, a margin is directly available for debt service. The hope has also been expressed, however, that ERP countries might earn dollars by means of triangular trade; i.e., by developing a surplus with third countries which have net dollar receipts either as a result of exports to or capital flow from the United States. Whether such a development will occur cannot be predicted. It will depend on two factors: (1) the extent to which the United States tends to import from and export capital to third countries, and (2) the use third countries make of these dollar receipts. The two factors cannot be analyzed separately. An estimate of probable U.S. imports from, say, Southeast Asia might yield the conclusion that a U.S. deficit is likely with this area if imports of this area from the United States are estimated on the basis of prewar trade relationships. However, the possibility must be considered that third countries will tend to turn to the United States for imports to a greater extent than before the war. Indeed, as a result of the war the industrial efficiency and level of production of the United States as compared with other industrial countries has increased so markedly that one cannot rely too heavily on a return to prewar trade relationships as Europe's industrial recovery nears completion.

Whether or not third countries will tend to spend dollar receipts in Europe will depend upon the rate of increase in industrial productivity in Europe as compared with the United States, the wage-price levels and exchange rates of the two areas, quality differences, export promotion activities, historical market relationships, and many other factors. It should perhaps be stressed that what is under consideration here is the extent to which non-European countries will tend to spend dollars in Europe; that is, Europe's ability to attract buyers who can equally well purchase from the United States.

The decline of Europe's investments in countries with which the United States might possibly be expected to develop a current account deficit is another factor which tends to reduce the possibility of Europe's earning dollars from countries other than the United States. In addition, it is important to remember that some non-European countries will also require dollars, over and above their current account requirements, for debt repayment to the United States.

As for the possibility that U.S. capital flow to third countries might be spent in part in ERP countries, some of the consideration set forth in the previous paragraphs would also apply. Moreover, U.S. private capital outflow has tended more and more to take the form of direct investment. It is to be expected that to a great extent such investment will not make dollar exchange available to the countries in which the investments take place, but will involve the direct importation from the United States of equipment and materials by the American investing firms.

Conclusion

It has been emphasized that there exists a great amount of uncertainty in attempts to estimate ability to repay prospective ERP loans. These uncertainties are more serious with respect to the transfer problem than the production problem.

The objections to providing either too much or too little of the ECA assistance on a loan basis should be considered. If a participating country receives loans substantially in excess of its ability to repay, it will be overburdened with debt service charges and will be forced either to default or to reduce its standard of living drastically in order to effect payments. On the other hand, in the interests of the taxpayers of the United States, it would appear undesirable to place too great an amount of the aid on a grant basis in cases where the participating country's ability to repay might justify a higher proportion of loans.

In view of these uncertainties, it would appear desirable to establish, in connection with loans by the ECA, a method of contingent repayment which would avoid the possibility of overburdening the debtors and, at the same time, tend to maximize the probability of repayment.

Contingent-repayment loans would be allocated among the participating countries on the basis of ability to repay assuming there will be no transfer problems; that is, an analysis of the type suggested in the first part of this paper would serve as a basis for decisions as to the amounts of loans to be extended to the various countries.

In order to provide for misjudgments of physical ability to repay and especially to provide for transfer difficulties in the future, the loan agreements would contain provisions permitting the waiving of interest payments, and perhaps the deferment or waiver of principal payments as well, under certain conditions.

The conditions would be expressed in terms of a formula which would permit debt service payments to vary from year to year in accordance with the recipient country's ability to make payments.

The formula would attempt to take account of fluctuations in some of the uncertain quantities previously mentioned; for example, the volume of imports of the debtor country; the size of its current account surplus; its net dollar earnings and receipts of dollar capital. Consideration might also be given to inclusion of a condition explicitly related to the U.S. balance of payments; such a condition might provide for reduction or postponement of debt service at times when the outflow of dollars from the United States on current and capital account was insufficient to finance both U.S. exports and foreign debt repayments due to the United States.

Whatever form such a formula might take, its primary purpose would be to permit modification of the repayment schedule when necessary and thus to minimize the probability of outright default. In addition, the adoption of a system of contingent repayment on ECA loans could be useful in indicating recognition of the fact that ability to repay may be dependent upon the actions of the creditor as well as those of the debtor.

NOTES ON THE SIGNIFICANCE OF SELECTED COMMODITIES FROM
EASTERN EUROPE FOR THE EUROPEAN RECOVERY PROGRAM

Caroline Lichtenberg

The purpose of this paper is to re-appraise the OEEC countries' prospects of importing certain commodities from Eastern Europe. The three commodities discussed--sawn softwood, coal, and grain--were selected because they constitute the bulk of the OEEC countries' import requirements from Eastern Europe.

Furthermore, an attempt has been made to compute the total costs to Western Europe of importing these same commodities from the Western Hemisphere should they prove unobtainable from Eastern Europe. Since shifting to imports from the Western Hemisphere would involve dollar outlays, that part of total substitution costs payable in dollars was also computed. However, no attempt has been made to deduct those dollar costs which arise through dollar payments for purchases of Eastern European commodities. More will be said about this in a later section.

Were East-West trade cut off, the OEEC countries would probably decrease consumption of these commodities and expand production as well as imports from alternative sources. It has been assumed here, however, that the entire deficit resulting from a withdrawal of Eastern European supplies could and would be made up by the Western Hemisphere. Presumably the United States and Canada would make every effort to assure Western Europe of its minimum requirements of these commodities:^{1/} overcutting in the North American timber industry would continue and domestic consumption of sawn softwood would be curtailed; the 1947 level of coal exports from the United States to the OEEC countries would have to be sustained, thus prolonging the pressure on inland transportation facilities; and the acreage now planted in certain grains would have to be maintained at its overexpanded level, thus retarding needed conservation measures. The computations have been summarized in the following table.

Sawn Softwood

Softwood lumber represents one of the most critical commodities in the European Recovery Program. The world-wide shortage was clearly recognized by CEEC, as is shown in the table. Columns 1 and 2 contain CEEC's estimates of softwood import requirements and of anticipated imports from all non-participating countries through 1951. The gap between these two sets of figures is 1,150 thousand standards annually, or over a third of the import requirements. It is therefore all the more important for Western Europe to obtain the anticipated imports. Column 8 of the table indicates that in drawing up the estimates of anticipated imports, CEEC counted heavily on movements from Eastern Europe. The projection for 1951, for example, assumed that over 70 per cent of Western Europe's total softwood imports would originate behind the "iron curtain". Furthermore, by increasing their anticipated exports by only a little more than one-quarter next year, Eastern Europe could wipe out Western Europe's entire deficit.

^{1/} Argentina and Brazil might also contribute by supplying grain and softwood.

OECE Countries' Import Requirements, Anticipated Imports from Non-Participating Countries, Estimated Imports from Eastern Europe, and Substitution Costs of Softwood Lumber, Coal, and Grain, 1948-51
(In millions of dollars) a/

Year	Import requirements from all non-participating countries	Anticipated imports from all non-participating countries	Estimated Imports from Eastern Europe		Estimated Costs of Substitution		Estimated Imports (Quantity) from Eastern Europe as % of Total	
			Quantity	Value	Total	Of which: dollar costs	Import requirements (Col. 3 as % of Col. 1)	Anticipated imports (Col. 3 as % of Col. 2)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)

SAWN SOFTWOOD ^{b/} (In thousands of standards)

1948	2,949	1,799	699	130	170	145	23.7	38.9
1949	3,098	1,948	898	165	220	185	29.0	46.1
1950	3,231	2,081	1,285	235	315	265	39.8	61.7
1951	3,301	2,151	1,526	280	375	310	46.2	70.9
Total				810	1,080	905		

COAL ^{c/} (In millions of metric tons)

1948	40	40	13	235	250	195	32.5	32.5
1949	37	37	15	270	285	225	40.5	40.5
1950	38	38	16	290	305	240	42.1	42.1
1951	34	34	18	325	340	270	52.9	52.9
Total				1,120	1,180	930		

GRAIN ^{d/} (In millions of metric tons)

1948-49	26.8	21.5	2.0	200	200	190	7.5	9.3
1949-50	27.1	22.4	2.9	290	290	275	10.7	12.9
1950-51	26.7	23.0	3.5	350	350	330	13.1	15.2
1951-52	26.7	23.5	4.0	400	400	380	15.0	17.0
Total				1,240	1,240	1,175		
Grand Total				3,170	3,500	3,010		

a/ All dollar estimates have been rounded to the nearest \$5 million and are on a c.i.f. basis.

b/ Import requirements, anticipated imports, and imports from Eastern Europe are from CEEC, Vol. II: Technical Reports, p. 395.

c/ Import requirements (which are also anticipated imports) and imports from Eastern Europe are from Coal Technical Report, MPAC/Tech 4/23 Oct. 1947 (Revised) - prepared by IBRD, Research Department, Samuel Lipkowitz and Charlotte Katz, p. 5. The estimate for imports from Eastern Europe in 1948 is one million tons higher than that projected by IBRD in light of more recent data from Polish sources.

d/ Import requirements from all non-participating countries for all years are from CEEC, Vol. II: Technical Reports, pp. 84-87. Anticipated imports from all non-participating countries and imports from Eastern Europe for 1948-49 and 1949-50 are from Commodity Report, European Recovery Program, Chapter A, Food and Agriculture, Statistical Appendix, Tables 1-3. The figures for 1950-51 and 1951-52 for anticipated imports and imports from Eastern Europe are estimates of the writer (see p. 17 of the text).

The estimates of imports from Eastern Europe (column 3) are extremely tenuous. This is particularly true with regard to the share in these estimates attributed to Russia and Rumania. The Soviet Union, which is the largest potential supplier of softwood, is at the same time the country whose export prospects are least known. Also for Rumania, which of course is less important, no official estimates were made available.

Two special assumptions have been made with regard to softwood imports from Eastern Europe. First, it is assumed that no strong inducements to step up exports in the form of an exchange of capital goods for more timber will be offered the Eastern European governments and that, as a result, they will export less than what they might otherwise make available. Secondly, it is assumed that no further credits will be extended to these countries by the OEEC countries, the International Bank for Reconstruction and Development, or the United States. Thus, for example, with respect to Poland, Czechoslovakia, and Yugoslavia, any additional quantities of softwood which would be available as a result of the timber loans recommended to the Economic Commission for Europe by the Timber Subcommittee^{1/} were not included. The Subcommittee states that had credits totaling about \$10 million been granted these three countries this year, their softwood exports to Western Europe in 1948 would have increased 30 per cent. If the International Bank, which has these loans currently under consideration, actually should grant them, exports next year, and presumably in 1950 and 1951 as well, are likely to be greater than has been projected here.

The costs of importing this softwood from Eastern Europe were calculated throughout on the basis of \$165 per standard, the price which Finland and the United Kingdom agreed to in a trade agreement concluded early in 1948, plus \$20 per standard for freight charges. The price used in estimating substitution costs is the U.S. lumber export price plus ocean freight charges (\$165 and \$80 per standard, respectively) which prevailed in April 1948. In computing the dollar costs for all the commodities, one-half the amount accounted for by ocean freight charges was deducted from the total costs of substitution. This was done on the assumption that half the quantities exported would be carried in foreign ships at no dollar cost. Were East-West trade severed, the OEEC ships which would normally carry goods from Eastern Europe would probably be diverted to the Western Hemisphere. Furthermore, the Economic Cooperation Act stipulates that at least 50 per cent of U.S. shipments under the Act be carried in American bottoms, and it can reasonably be assumed that the OEEC countries will make every effort to carry the remainder.

Coal

The estimates with regard to coal are essentially those calculated by the International Bank for Reconstruction and Development.^{2/} The figures for import requirements, which are substantially lower than those projected by CEEC, reflect the IBRD's smaller figure for total coal requirements. These requirements were reduced primarily on the assumption that the levels of coal consumption stipulated in the Paris Report for certain OEEC countries, and

^{1/} Council of FAO, Report from the Director General to the Second Session of the Council of FAO on European Activities of FAO in the Field of Forestry and Forest Products, CL 2/8, March 19, 1948, p. 11.

^{2/} IBRD, Coal Technical Report, MPAC/Tech 4/23 Oct., 1947 (Revised). Prepared by Samuel Lipkowitz and Charlotte Katz of the Research Department.

principally France and Italy, would not be necessary as a result of "projected increases in petroleum (in all countries) and in electric power output (in France, Italy, and Austria)..." ^{1/}

The International Bank's figures representing anticipated imports of Polish coal into the OEEC countries differ markedly from estimates made by both CEEC and the U.S. Administration largely because of the IBRD's assumptions "that Poland's production will be retarded by lack of sufficient power-generating capacity, and that exports to 'non-Marshall' countries, particularly the U.S.S.R., will remain at levels close to those experienced in 1946-47."^{2/} Poland was indeed able to attain in 1947 the production goal set out in the Polish Economic Plan. She may also fulfill the plan for the current year. The likelihood is, however, that Poland will not succeed in attaining the planned target for 1949. To fulfill the plan for that year and to assure further expansion would have required substantial new investments in the coal industry. The CEEC Report assumed that such investments would be carried out. Although Poland will probably acquire some capital goods from Western Europe in exchange for coal or from the United States via ECA or other sources of dollars, the capital equipment so obtained is likely to be insufficient for the purpose of reconstructing the coal industry. As a result total exports will be reduced. Moreover, while CEEC and the Administration assumed that exports to the Soviet Union would decline rapidly, more recent information indicates that the eastward movement of coal will continue to be heavy and that Eastern Europe will take about 11.5 million tons annually, or about 48 per cent of total Polish exports in 1948 and 38 per cent in 1951. A further indication that Poland's exports of coal to Western Europe will be considerably less than anticipated in earlier reports lies in the fact that, as a result of the improved coal supply situation throughout Europe, certain OEEC countries have recently rejected Polish coal, primarily because they couldn't meet Poland's requests for payment in dollars or capital goods. Thus Western Europe's growing unwillingness to accept Polish coal on Polish terms further substantiates the reasonableness of the International Bank's figures.

The costs of importing from Poland the quantities shown in column 3 of the table were arrived at by applying an average price for Polish coal of \$18 per ton, landed in Western European countries. The total costs of substitution are based on current U.S. coal prices and ocean freight rates, which give a landed cost of about \$19 per ton. From these figures, freight charges for one-half the amount were deducted in order to arrive at dollar costs, again on the assumption that these quantities would be carried in foreign ships.

Grain

Grain, like sawn softwood, is expected to be in short supply throughout the period of the Marshall Plan. A comparison of import requirements and anticipated imports from all non-participating countries (columns 1 and 2 of the table) indicates that the deficits may be about 20 per cent of import requirements in 1948-49, 17 per cent in 1949-50, 14 per cent in 1950-51, and 12 per cent in 1951-52. Before the war, a substantial portion of Western Europe's total grain imports came from the Eastern European countries, and the revival of this trade would be of considerable value to

^{1/} Ibid., p. 4.

^{2/} Ibid., p. 6.

Western Europe in her plans to rebuild livestock populations and improve bread rations. The figures in column 8 of the table show that over 9 per cent of Western Europe's grain imports are expected to originate in Eastern Europe in 1948-49 and about 17 per cent in 1951-52.

It is very difficult to prepare estimates of Eastern Europe's future grain exports because of the unpredictability of such factors as the weather, the effects on output of land reforms and collectivization, the levels of consumption that will prevail, and the export policies of Eastern European governments. Nevertheless, since the Administration made its estimates last October, more data on Eastern Europe's commitments for exports from the 1947 and 1948 crops have become available and they indicate higher exports to Western Europe than were previously assumed. On the basis primarily of this information in conjunction with prewar data, the estimates for 1950-51 and 1951-52 have been raised by 600,000 tons and 1.1 million tons, respectively.

Since the price of grain landed in Western Europe is essentially the same for U.S. and U.S.S.R. grain, the same price of \$100 per metric ton for all grains was used in calculating the costs. As in the case of sawn softwood and coal, estimated dollar costs of substitution are merely the total substitution costs less freight charges for half the estimated grain imports.

The Cost Estimates

The cost figures are subject to serious limitations. Since no attempt was made to project the course of prices, these figures, calculated on the basis of current prices throughout, should be regarded as suggesting only general orders of magnitude. Eastern European prices of timber, coal, and grain are likely to decline. In particular, Polish coal, now considerably overpriced, is already feeling the effects of increased production in Western Europe and of American competition, and there have recently been signs of weakening in the timber market. On the other hand, although it is generally accepted that the U.S. price level will decline in the next few years, there might be a tendency for the prices of the commodities under review to remain at current high levels if additional supplies were to be exported to Western Europe. Thus the projected differential cost may well be somewhat higher than is shown here.

If this possible underestimation of the differential is neglected, a comparison of the two sets of total cost figures suggests that while Eastern Europe might be a somewhat cheaper source than North America for these three commodities, this is owing almost entirely to the differences in transportation costs. Since the OEEC countries' dollar payments to Eastern Europe were not computed, the net additional dollar outlay resulting from a shift to the Western Hemisphere would be less than that shown in the table. The figures therefore give only the upper limit for the amount of dollars Western Europe would save by trading with Eastern Europe and of the value of additional exports she would have to sell in Western Hemisphere markets.

ECA PURCHASES IN WESTERN EUROPE

R.W.B. and C.L.

During the first months of operations by the Economic Cooperation Administration, the financing of dollar purchases in the participating countries has necessarily been conducted on an item-by-item basis, without giving first regard to economy of operations. Thus, \$7 million was allocated to Greece, Italy, and the Netherlands to finance purchases of coal from Western Germany, and about \$5 million was allocated to Western Germany for purchasing foodstuffs from Greece, Italy, and the Netherlands. Reasons were not lacking for this double financing, but it is to be hoped that the machinery can soon be made to run in a manner which will reduce the number of dollar transactions to a minimum.

The accompanying table shows ECA authorizations for procurement from participating countries and their dependencies through July 3, 1948, and is arranged to indicate each country's gross and net earnings of ECA dollars from intra-European trade. Total dollar transactions between ERP countries authorized by ECA during this period amounted to \$65 million, although \$42 million would have been sufficient to move the same volume of goods. Whether or not this represented merely circuitous bookkeeping operations or an actual over-financing of requirements depends on the extent to which account was taken of anticipated receipts from ECA purchases in each country's direct dollar aid allocation. If account was taken of the full \$65 million actually expended, then no over-financing occurred.

It is a further question whether even the net amount of \$42 million would have been required to finance the given volume of trade had a fully automatic system of multilateral clearing been in operation among the ERP countries. A thorough clearing would probably have permitted a portion of the trade to be financed with existing balances in European currencies. But so long as this mechanism is not available, the ECA is likely to find itself financing a greater volume of intra-European transactions than is necessary.

ECA Dollar Purchases in ERP Countries and Dependencies,
Through July 3, 1948
(In millions of dollars)

Importing Country Country of Procurement	Austria	Denmark	France	Greece	Italy	Nether- lands	United Kingdom	Western Germany	Total	Net Receipts
Belgium-Luxembourg	.7 *	-	-	-	-	-	-	11.5	12.2 *	12.2 *
Denmark	-	-	-	-	-	-	-	.8	.8	.76
France	-	-	-	-	-	-	-	1.2	1.2	-
Greece	-	-	-	-	-	-	-	2.5	2.5	1.3
Iceland	.2	-	-	-	-	-	-	-	.2	.2
Italy	.05*	-	-	-	-	-	-	3.0	3.05*	-
Netherlands	.15*	-	-	-	-	-	18.2	2.2	20.55*	16.85*
Norway	1.2	-	-	-	-	-	-	3.0	4.2	4.2
Portugal	-	.04	-	-	-	-	-	1.4*	1.44*	1.44*
Switzerland	.7 *	-	-	-	-	-	-	-	.7 *	.7 *
Turkey	-	-	-	-	-	-	-	4.2*	4.2 *	4.2 *
Western Germany	1.0 *	-	2.3	1.2	6.0	3.7	-	-	14.2 *	-
Total	4.0	.04	2.3	1.2 ^{a/}	6.0	3.7	18.2	29.8	65.24 ^{a/}	
Net Payments	4.0	-	1.1	-	2.95*	-	18.2	15.6*		41.85

* Wholly or in part based on arbitrary assumption that procurement was divided equally among alternative sources of supply named in the pertinent procurement authorizations.

^{a/} Excluding an additional authorization to Greece to purchase \$4 million of foodstuffs and textiles from unspecified sources.