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THE ITALIAN ACCUMULATION OF DOLLAR BALANCES

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Summary

Considerable interest has been aroused by the large increase in Italian dollar balances during 1948. (From January to September, an increase of $152 million approximately doubled short-term Italian-owned balances as reported by U.S. banks.) Two types of questions may be asked in regard to this increase: First, what were the balance-of-payments items which resulted in this accumulation; and second, why did they occur, in view of the fact that in this period Italy was receiving U.S. aid which was planned merely to cover the difference between Italy's projected dollar receipts and its dollar needs?

In regard to the first type of question, investigation to date has failed to account for the entire amount of the increase, but most of it appears to have arisen from transactions with the U.S. Additional dollars were probably acquired in some Latin American and some European countries.

In regard to the second question, the increase in reserves must mean that Italian dollar receipts were greater than expected, or Italian payments were less than expected, or both. A comparison between actual trade with the Western Hemisphere and the estimates made for the first two quarters of the European Recovery Program shows the performance to have surpassed the program, both in expanding exports and in holding down imports but chiefly on the export side.

This development in turn is traceable chiefly to the exchange devaluation and the monetary and credit measures of late 1947. There is evidence to indicate that the improved balance of trade, at least in some commodities, was achieved by a reduction of inventories rather than by a decline in the level of home consumption. This is not necessarily undesirable, however, in view of the excessive building up of these inventories in an earlier period. Part of the dollars thus accumulated might be advantageously used for an expanded investment program.

I. The Extent of the Dollar Accumulation

Italian gross short-term dollar balances as reported by U.S. banks rose from $153 million to $305 million over the first nine months of 1948, or by $152 million. (The rise actually dates from November 30, 1947, at which time total balances amounted to $146 million.) Of the increase in 1948, $128 million represented increased Italian official balances, and $24 million increased private balances. Italian short-term liabilities to U.S. banks in this period fell from $21 million to $16 million; hence the change in net short-term assets is little different from the change in gross.

Italian figures show a smaller, though by no means an inconsiderable rise, namely about $100 million during the year 1948. The discrepancy can be explained by the fact that Italian figures include only amounts held by the Ufficio dei Cambi and authorized banks, together with amounts held for exporters in what is known as the "50% accounts". Balances held by official institutions outside the Ufficio dei Cambi are not included in the Italian figures; and, of course, the "50% accounts" does not exhaust the category of private Italian balances.

It may be pointed out that Italy's hard currency accumulation is not confined to dollars; official Swiss franc holdings have increased heavily during 1947, and there seems reason to assume increased private holdings as well. Italian gold holdings remained constant over the entire period, until the recent acquisition of approximately twelve tons of gold from Switzerland.

This discussion will be confined to the known dollar accumulation, as represented by figures from U.S. reporting banks.

II. Composition of the Dollar Accumulation

The first question to be raised in regard to the dollar accumulation is: Of what does it consist? That is, what were the balance-of-payments items which led to the accumulation of $150 million by Italy in this period?

No full answer can be given to this question, due to the lack of data on the dollar balance of payments of Italy in 1948. However, an informal attempt by the Commerce Department 1/ to draw up a nine-month balance of payments with

1/ Unpublished material.

the U.S. suggests that there was an accumulation of dollars from U.S. sources alone of $110 million, out of the $150 million accumulated in all. The figure is arrived at in the following way: Practically all U.S. exports to Italy in this period ($323 million) were financed by the U.S. Government, in the form of Interim Aid, ECA assistance, Export-Import Bank disbursements, etc. Thus, the debit items, consisting chiefly of imports from Italy ($63 million), personal and institutional remittances ($39 million) and travel ($11 million net) were almost entirely net gains to Italy. These figures are highly tentative, due to the difficulty of compiling this type of information, and are incomplete in that they do not include an estimate for freight payments. Since this item would doubtless amount to a net credit for the U.S., the $110 million figure mentioned for dollars acquired from the U.S. would be reduced.

Furthermore, it seems likely that Italian exports to the U.S. (and also to other dollar-paying countries) may be understated. The Italian exporter's motive would be to avoid payment of the full 50 percent of his export proceeds to the authorities, while the American importer might be willing to cooperate in this project in order to reduce his import duties. This is a widespread practice in countries where exchange controls are in effect. If the excess dollars were further concealed by being retained in the name of the American importer, they would not, of course, help to explain the reported dollar accumulation. But if they were held in an American bank in Italian name, they would appear in Italian private balances without showing in trade statistics, and hence might form part of the unexplained balances.

If we consider dollar transactions with other countries, in an attempt to account for the remainder of the dollar accumulation, we find little positive information. The possibilities, however, include:

(a) dollar earnings in some Latin American countries (especially as a result of Italian use of local currencies or lire to pay for purchases there);

(b) some saving of dollars by the system of franco valuta imports;

(c) direct dollar earnings in a few European countries; and

(d) indirect dollar earnings by the re-export of goods purchased in the sterling area.

In the Western Hemisphere, Italy had an over-all import surplus in the first nine months of 1948, but had export surpluses with Colombia, Mexico, Panama, and Venezuela, totaling in the neighborhood of $15 million. It is very likely that dollars were earned by Italy in these countries, 1/ though not necessarily

1/ Mexico and Venezuela have no exchange controls over out-payments, and Colombia permits payment of dollars for approved imports.

to the extent indicated by the trade balance. Other currencies may have been used in part payment of Italian exports, thus reducing the dollar earnings. On the other hand, dollar earnings may have exceeded the trade balance insofar as (1) Latin American currencies were used in payment for Italian imports, (2) invisible payments were made to Italy in dollars, or (3) capital movements occurred. (These factors of course apply to countries with which Italy had a trade deficit, such as Cuba, as well as trade-surplus countries).

Remittances from Italian immigrants may have played a part even where they could not be made in dollars, in that they may have helped finance Italian imports from Latin America, thus allowing Latin American dollar payments for Italian exports to accrue to Italy.

Latin American countries, with the exception of Mexico and Venezuela, have fairly rigid and effective capital controls, so that transfers of dollars on capital account would be unlikely, except from these two countries. 1/

In connection with Western Hemisphere trade, it is possible that the system of "franco valuta" imports may have saved Italian exchange authorities some dollars in payment for imports; and to the extent that the dollars used for importing were previously unreported, this might account for a small portion of the unexplained accumulation. However, the system was considerably restricted in June, and in any case could not have applied to any large amount of imports from the U.S., since most of these were financed by U.S. foreign aid.

In Europe, Italy had an export surplus with most of the large countries in this period. However, only Belgium is known certainly to have paid dollars to Italy, in the amount of something under $10 million. Switzerland may have made dollar payments to Italy, under the terms of her November 1947 trade and payments agreement. This agreement contained a list of products for which Switzerland was prepared to pay in freely convertible exchange, and for which no Swiss import permits were required. The aggregate value of such special imports was not permitted to exceed SF60 million (about $14 million) a year. The recent Italian

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1/ In regard to possible capital transfers, which would very likely appear in U.S. figures as private rather than official holdings, it might be objected that the greatest increase in Italian dollar balances occurred in the official accounts, so that such capital movements need not be considered seriously. However, it is possible that an inflow of private dollar balances might have been accompanied by a shift of balances from private to official account, as a result of the U.S. vesting program announced in February 1948. That is, Italian holders of blocked dollars (hitherto appearing as private balances) might have been declaring them and transferring them to the Italian Government, at the same time that new private dollar balances were being acquired from sources outside the U.S. While it is not known how many dollars were acquired by the Italian Government in this way, it was estimated by the U.S. in January 1948 that about $8 million in Italian short-term assets, $6 million in securities, and $29 million in direct investments and other assets remained blocked at that time.

acquisition of twelve tons of gold from Switzerland, previously mentioned, was reported to be in settlement of a "clearing balance" of SF50 million. It is not entirely clear whether this refers to the balance on account of the "special imports", but if it does, the possibility of dollar payments to Italy during 1948 is reduced. It is probable that Turkey also paid a small amount of dollars to Italy; a 1947 payments agreement provided for dollars to be used in settlement for goods exchanged, and during the January-September period the trade favored Italy by about $3 million.

There is no evidence to indicate other European dollar payments to Italy.

As regards the rest of the world, Italy had trade surpluses in January-September 1948 only with Egypt, Syria, and a few sterling area countries. 1/ Payments with the sterling area are required to be settled in sterling under the terms of the U.K.-Italy agreement previously mentioned; and dollar receipts from Egypt or Syria seem unlikely. With the sterling area as a whole, Italy had an import surplus in this period, though by no means as large a one as might be indicated by the decline in Italian sterling balances. Part of this decline would be due to an invisible balance in favor of the sterling area, and another part is no doubt due to prepayment of sterling area purchases, in anticipation of the appreciation of the pound-lira rate. However, it is quite possible that a portion of Italian sterling went to pay for imports which were transshipped to a hard currency area. This type of transaction would have been especially profitable in the early part of 1948, when the discount on sterling in Italy was considerable. If the transaction were entered by the Italian customs' authorities as "Transit Trade", it would not appear in either the import or export statistics of Italy. Thus, a sterling loss and a hard currency gain would be registered, without a counterpart in trade statistics.

In summary, while there is little factual proof, Italy might have supplemented its known dollar earnings in the U.S. by acquisitions in a few Latin American countries, in Belgium, Switzerland, and possibly small quantities elsewhere in Europe, and by the re-export of goods purchased in the sterling area. It would seem desirable to make further attempts to ascertain which of these various possibilities are correct.

III. Italian Trade Performance

Leaving aside the question of dollar source, the further question might be asked: why did the accumulation occur? Aid to Italy under the European Recovery Program was based on the theory of financing the expected dollar deficit, no more and no less. Obviously the actual dollar deficit in the period from the beginning of the program to September 30, 1948, was less than expected. If all dollar payments and receipts in this period were known, they could be compared with the estimates on which E.R.P. allotments were made, and the exact source of

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1/ India and British African possessions.

the difference located. In the absence of such information, it is possible to compare actual with estimated Western Hemisphere imports and exports in the period April-September 1948. The following table does this, and also indicates the percentage relation between actual and program figures.

Actual & Programmed Italian Trade with Western Hemisphere 1/
(In millions of dollars)

	Imports				Exports			
	Actual 2/	Program 3/	Departure from Program	% Actual to Program	Actual 2/	Program 3/	Departure from Program	% Actual to Program
Apr.-July 1948	271	278	7	97%	83	50 4/	33	165%
July-Sept. 1948	171	218	46	79%	76	42	34	181%

1/ Western Hemisphere commodity trade, actual and programmed, is used merely for purposes of evaluating the Italian trade performance. Nothing is implied as to the relation between these figures and total dollar trade, nor as to the anticipated extent of E.R.P. as vs. other means of financing.

2/ From official Italian statistics. A rough adjustment was made to import statistics to make the c.i.f. figures more nearly comparable with program figures.

3/ From State Department and E.C.A. material. (Note that the second quarter allotment was based on four months' requirements.

4/ Total dollar exports.

It is clear from these figures that, while Italian imports from the Western Hemisphere fell short of the program and Italian exports to the Western Hemisphere exceeded it, the excess of exports, in absolute figures and on a percentage basis, was considerably greater than the deficiency in imports. From this it can be seen where the emphasis should be laid, in accounting for the behavior of the dollar balances: Improved export performance was obviously more important than restrictive factors operating on imports.

It would be of further interest to know what factors operated on each side of the trade balance; and if possible, to know whether the improved performance was achieved at the expense of consumption or stocks, or resulted from increased production. For this purpose, a detailed commodity-by-commodity study of both the program and the results is actually called for. The writer has not succeeded in carrying out such a study, but some fragmentary data will be later cited in this connection.

In discussing factors operating on the trade balance, the relevant comparison for purposes of explaining the dollar accumulation, is one between actual and expected conditions in 1948; not merely the change in conditions from 1947 to 1948. However, in the absence of full information on price and other assumptions used in setting up the program, it may be helpful to discuss movements over time, since marked movements over time are likely not to have been anticipate when the program was set up. 1/

On the import side, the following factors may be mentioned: (1) The rise in dollar prices of imports 2/ in combination with the devaluation of Nov. 1947 undoubtedly had a restrictive effect. In spite of the fact that imports from the U. S. were largely financed by U. S. aid, private Italian importers were nevertheless influenced by (lire) price considerations in making foreign purchases. It is a fact that Italy, and no other country, had price difficulties in selling its E.R.P. imports internally. (2) The internal price stabilization of 1948 would be expected to accentuate the difference between lire prices charged by domestic and foreign suppliers, thus increasing the restrictive effect

1/ In accordance with this, the trade data already given may be supplemented with the following figures showing Italian trade with the U. S. by quarters for 1947, and for three quarters of 1948; as reported by the U. S. Dept. of Commerce, Bureau of the Census:

		Imports from U. S.		Exports to U. S.	
1947	1st quarter	137.4		12.0	
	2nd quarter	155.2	389.7	9.5	28.8
	3rd quarter	97.1		7.3	
	4th quarter	109.8		15.4	
1948	1st quarter	117.1		20.0	
	2nd quarter	118.3	307.5	23.5	62.8
	3rd quarter	72.1		19.3	

2/ The unit value index of U. S. exports (based on 1923-25) rose from 128 in 1947 to 137 in the first half of 1948; while an Italian index of import prices expressed in dollars (based on 1938) rose from 204 in 1947 to 235 in the first half of 1948.

on imports. (3) Connected with the second point, but viewed from the seller's side instead of the buyer's, is the tendency of price stabilization and credit restriction to encourage the dishoarding of raw material stocks. It seems probable that there was such a reduction of stocks though the evidence is indirect. (4) "Low" industrial activity may have been responsible for some of the import deficiency, in the sense that a higher level of activity, with a given rate of use of stocks, would of course have called for more imports.

As evidence of the reduction of stocks in the textile industry, the following figures may be cited, showing the import, manufacture, export and domestic sale of certain textile materials:-

Italian Statistics Relating to Textile Materials a/

	Jan.-Sept. 1947	Jan.-Sept. 1948
	(In thousands of tons)	
Cotton		
Import of raw material	170	100.3
Production		
Yarn	137.7 b/	142.2 b/
Cloth	85.5 b/	95.4 b/
Export		
Yarn	11.2	22.5
Cloth	8.5	8.2
Wool		
Import of raw material	117.6	45.0
Production		
Yarn	62.1 b/	65.7 b/
Cloth	28.8 b/	30.6 b/
Export		
Yarn	3.4	2.7
Cloth	4.6	4.7
Rayon		
Import of raw material	61.7	26.6
Production		
Yarn	60.0 c/	50.4 c/
Export		
Yarn	9.7	27.9
Cloth	5.9	6.2
	First half 1947	First half 1948
Quantity index of department store sales of textiles and clothing	100	134

a/ Bank of Italy, Research Department
b/ January-July rate projected
c/ January-June rate projected

From this it appears that, while the import of raw cotton, wool, and cellulose fiber fell sharply from 1947 to 1948, production of yarn and cloth increased. It is of course possible, though improbable, that imports in 1947 were so high that even after a sharp decline, stocks need not have been used in 1948. The 1948 figures taken alone seem to further disprove this possibility: In the case of cotton, wool, and rayon, the production of yarn alone exceeded the import of raw materials. When it is considered that a part of the raw materials are no doubt used for other purposes than the manufacture of yarn and cloth, and that a certain amount of waste is involved in manufacture, it is clear that raw material stocks in these commodities must have been reduced in 1948. While it was not possible to make a thoroughgoing comparison with program estimates, it can be stated that the April-July program anticipated no change in raw cotton stocks.

The reduction of raw material inventories in 1948 should be viewed in the light of the building up of these inventories through hoarding in the pre-Einaudi period, and with the fact that the Einaudi monetary and credit measures were designed to bring about precisely this result.

On the export side, the important factor was undoubtedly the devaluation of November. The Italian index of export prices expressed in dollars fell from 212 in 1947 to 200 in the first half of 1948; and the increase in dollar export values in 1948 1/ in spite of this price decline is evidence of the demand elasticity for Italian exports. 2/ The effect of the devaluation was no doubt heightened by internal price stabilization, which increased the lire price differential between domestic and foreign sale.

It is difficult to say whether a reduction in stocks of finished goods accompanied the export increase. The evidence in the case of textiles is much less conclusive than it was on the import side, as will be seen by reference to the table on page 8. Exports of cotton and rayon yarn increased sharply over 1947, while production increased but slightly in the former case, and declined in the latter case. However, nothing can be said about domestic sales, since the sales figure is not broken down by type of textile. Furthermore, nothing can be deduced from an examination of 1948 figures alone, for the same reason. It is nevertheless possible to hazard the hypothesis that there was a decline in stocks of finished goods, since the same factors making for a dishoarding of raw material

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1/ See note 1, page 7. It may be noted that no participating country except Germany showed so great a % improvement in exports to the U.S. in 1948 over 1947; and none except the U.K. showed a greater absolute improvement. The Italian increase for January-September 1948 over the same period in 1947 was $34.1 million, or 118%. German exports to the U.S. rose by over 400%, but by a much smaller absolute amount; British exports to the U.S. rose by $56 million, but by a smaller percentage.

2/ See this Review, December 14, 1948, "Economic and Financial Conditions in Italy" inventories (price stabilization, credit restriction, etc.) should have operated here as well.

III. Conclusions

To the extent that the improvement in the Italian balance of payments was accompanied by a reduction of inventories, it is a one-time occurrance; any repetition would have to be on the basis of increases in production. However, over a longer period such production increases may be expected; and the short-run effects on the balance of payments in the meantime are useful. Furthermore, any reduction in stocks which took place is not necessarily undesirable in itself since, as has already been mentioned, much hoarding occurred prior to the monetary reforms, due to the upward movement of prices, the external depreciation of the lira, and the anticipated devaluation.

The calculation of Italy's second year E.R.P. allotment cannot fail to be influenced in part by this year's developments, in that expectations as to performance will be more optimistic than they would otherwise have been. However, this does not mean that Italy should be expected to use her newly acquired balances to cover a 1949 deficit. In the first place, since the level of Italian dollar holdings had fallen so low in the latter part of 1947, some permanent increase would not seem undesirable. Furthermore, if such a requirement were regarded as penalizing superior performance, it would have an undesirable psychological effect.

However, it would seem that Italy might well put the dollars to constructive use. The fact that Italy now possesses a not negligible foreign exchange reserve which could be used, if necessary, to counteract inflationary pressures, may cause the Italian Government to act more boldly than hitherto in planning for economic development.

ITALO-SOVIET AGREEMENTS ON REPARATIONS AND TRADE

Gregory Grossman

On December 11, 1948, after some four months of delicate negotiations in Moscow (which also involved the transfer of Italian warships to the Soviet Union), four economic documents were signed by representatives of Italy and the U.S.S.R. These comprised (1) a treaty of commerce and navigation, which is yet to be ratified by the Italian Parliament, (2) an agreement regarding the payment of reparations to the Soviet Union under the Italian peace treaty, (3) a trade agreement providing for mutual deliveries over a three-year period, and (4) a payments agreement to supplement the trade agreement. The full texts of the documents are not available here at this writing, but the preliminary information received permits a number of comments to be made on the economic significance of the agreements from the points of view of Italy and the U.S.S.R., as well as the broader points of view of East-West trade and of the E.R.P.

Not much is to be said on the first and fourth of the above-listed documents. The treaty of commerce and navigation is notable for the omission of the word "friendship" from its title. It is not clear in the absence of the full text of the treaty how far it goes in the mutual extension of most-favored-nation treatment. The communique published in the Soviet press 1/ lists such treatment to cover matters of "customs, transportation, internal levies, and navigation" with certain unspecified exceptions. Press reports from Rome suggest a much more restricted scope of most-favored-nation treatment. 2/ Whatever the exact stipulation in this respect may be, the concession is for all practical purposes a one-sided one by Italy in view of the state trading monopoly obtaining in the U.S.S.R.

The payments agreement does not involve gold or free exchange. Payments are to be affected through a set of lira accounts. In case of fluctuations in the exchange value of the lira, the net balances of these accounts are to be adjusted monthly in accordance with the variation in the average of the "official" and the "free" dollar -- lira rates. The maximum net balance allowed is a rather small one considering the magnitude of trade envisaged: only about one million dollars (600 million lire). The final net balance outstanding is to be settled in commodities.

The Agreement on Reparations

The agreement on reparations is intended to bring into effect the provisions of the treaty of peace with Italy regarding the transfer of reparations to the U.S.S.R. (Article 74(a)). The provisions of the peace treaty read, in part, as follows:

1/ *Pravda*, December 14, 1948

2/ *The New York Times*, December 15, 1948

"1. Italy shall pay the Soviet Union reparation in the amount of $100,000,000 during a period of seven years from the coming into force of the present Treaty. Deliveries from current industrial production shall not be made during the first two years.

"2. Reparation shall be made from the following sources:

(a) A share of the Italian factory and tool equipment designed for the manufacture of war material, which is not required by the permitted military establishments ... ;

(b) Italian assets in Roumania, Bulgaria and Hungary, subject to the exceptions specified in paragraph 6 of Article 79; 1/

(c) Italian current industrial production, including production by extractive industries."

Thus, the peace treaty left a number of very important elements undefined for later negotiation between Italy and the U.S.S.R., constituting a potential source of friction. For instance, on the basis of what price level were the goods making up the $100 million to be valued? What fraction of the total reparation bill was to be satisfied, respectively, from the three separate sources listed under paragraph 2, and could it be satisfied entirely from only one or two of these sources? The lack of precision in these respects might have been particularly regretted in view of the earlier experience with the equally vague reparations provisions of the armistice agreements with Finland, Rumania, and Hungary, and with certain similar provisions of the Potsdam Agreement. Those provisions gave rise to greater than anticipated demands by the U.S.S.R., and contributed to the deterioration in post-war international relations.

The agreement actually reached is quite favorable to Italy, considering the vagueness of the peace treaty, and considering also the conditions imposed by the U.S.S.R. on Finland, Rumania, and Hungary -- the last two now faithful satellites of the Soviet Union. The U.S.S.R. agreed to accept on reparations account all the Italian assets in Rumania, Hungary, and Bulgaria, as constituted at dates of armistice with the three Danubian countries, and valued in dollars as of September 15, 1947 (the date on which the treaty of peace came into effect). Actual transfer values are to be agreed upon by bipartite commissions, and to be finally determined by the ambassadors of the four Great Powers in Rome, as stipulated in the treaty. The difference between the total obligation of $100 million

1/ The exceptions specified in paragraph 6 of Article 79 refer to certain minor types of assets, such as diplomatic property, that belonging to religious bodies, literary and artistic property rights, etc.

and the value of the transferred assets is to be delivered from current production in five equal annual installments, beginning from September 15, 1949.

Soviet willingness to accept against reparations all of the Italian assets in the three satellite countries, and the method of valuation agreed upon in principle, are very significant concessions to Italy. These assets have already been largely nationalized by the several states within whose borders they are located, and prospects for compensation were not very bright. Moreover, had Italy retained title to any of these assets, their profitable utilization would have been at the sufferance of the several pro-Soviet governments. On the other hand, the U.S.S.R. already had ultimate control over these assets by virtue of its dominant position behind the "iron curtain".

Reported estimates of the value of these assets range from Italian figures as high as $60 million down to a figure of $15 million given by Mr. Molotov, speaking at the Paris peace conference in 1946. Italian long-term investments in the three Danubian countries in 1938 were estimated (presumably in 1938 values) at $28.8 million, 1/ but this figure included government-owed debt which is here not in question.

Should $40-50 million, for example, of the total reparations obligation be settled by the transfer of these assets, deliveries from current production on reparations account will amount to $10-12 million annually for the five years. Initially, the Russians demanded valuation in terms of 1938 prices, but the agreement as concluded calls for valuation in terms of currently prevailing prices. It will be recalled that the three reparations-paying satellites are nominally credited at 1938 prices, adjusted upward by 10 or 15 percent, and that the value of their deliveries in terms of current prices has been estimated to be 1.5 to 2.5 times the nominal value. Therefore, in this respect Italian negotiators have scored a significant victory.

Judging from preliminary information, the technical details of the transfer of goods will also be different from those employed with respect to the satellite states. Rather than being committed to deliver specific quantities of commodities, the Italian government will once a year turn over lira funds to a special account, to be drawn against by the Soviet government in payment for orders to be placed with Italian firms. The commodities to be ordered are specified in the agreement. The size of the lira funds depends on the dollar-lira rate, but apparently there is no safeguard against any additional depreciation in the internal purchasing power of the lira.

The bulk of the orders is to be placed in the capital goods industries, especially in shipbuilding which may account for over one-half of the total value

1/ Lewis, C., Debtor and Creditor Countries: 1938, 1944; The Brookings Institution, Washington, 1945, p. 65.

of deliveries from current production. The U.S.S.R. is to deliver, against compensation, materials normally imported by Italy and required for the production of reparations goods.

It will be noted that despite the permissive provision of the peace treaty, no dismantled equipment from Italy's excess war plants is to be delivered to the U.S.S.R. on reparations account. Russia's lack of interest in such deliveries is quite understandable. Apart from its own large wartime munitions production capacity, the U.S.S.R. has obtained large quantities of similar equipment by dismantling in Germany, Manchuria, and elsewhere. The goods to be newly produced by Italy seem to be of much greater interest to the Soviet economy at this time. For instance, the U.S.S.R. has been placing or attempting to place shipbuilding orders in a number of countries recently, largely to expand the Soviet fishing industry. Fish has been virtually the only foodstuff which the U.S.S.R. has been purchasing in large quantities outside of the "iron curtain" area since the end of the war, and its significance as a source of protein has been vastly increased because of the disastrous livestock losses suffered in the war. It is possible that some of the artificial fibers, ball bearings and other materials to be delivered by Italy are for ultimate use by satellite industries. 1/

It should be borne in mind that the U.S.S.R.'s annual reparations receipts from Italy will be quite small in comparison with its annual reparations receipts from the three satellite states and from Eastern Germany. By value, at current prices, they will amount to only about 10 percent of the combined annual receipts from Finland, Hungary, and Rumania, not to mention the vastly larger receipts from Eastern Germany. 2/

From the Italian point of view, the annual reparations deliveries to the U.S.S.R. will amount to only about one percent of the anticipated value of total Italian exports. Very fortunate also is their concentration in the capital goods industries, especially shipbuilding. These have been, since the war, Italy's "ailing" industries, suffering from excess plant capacity and serious unemployment, and presenting the Italian government with a delicate internal political situation, especially vis-a-vis the Communist labor unions. 3/ Thus, repa-

1/ The U.S.S.R. has commitments to deliver ball bearings to Hungary and Czechoslovakia in recent trade agreements.

2/ The latter have been estimated to be at an annual rate of some two billion 1936 reichsmarks, or about one billion current dollars; see "A German Report on Reparations", this Review, June 1, 1948, p. 16.

3/ Cf. "Economic and Financial Conditions in Italy", this Review, December 14, 1948.

rations production will re-employ some currently idle resources, will not require considerable induced investment, (hence, minimizing inflationary pressure), 1/ and may somewhat ease internal political pressure.

Also fortunate for Italy is the absence of penalty provisions for delayed deliveries. The three reparations paying satellite states are subject to penalties of 5 percent per month in the event of delayed delivery. This has led not only to an aggravation of the reparations burden, but has also placed the paying government (especially in Finland) in a vulnerable position in the event of threats of work stoppage on the part of labor unions or producers.

The Trade Agreement

The trade agreement involves much greater annual magnitudes than the deliveries from current production under the reparations agreement. It foresees a balanced trade of some $87 million in each direction per annum, and consists of:

(a) A protocol for the annual exchange of commodities to the value of 30 billion lire ($52 million) in each direction over a period of three years. The first year's exchange is to consist of 400,000 tons of grain, as well as lumber, iron ore, and other raw materials, from the U.S.S.R., and largely capital goods and other industrial products, as well as some hemp, sulphur, pyrites, lemons, almonds, and other commodities from Italy.

(b) A protocol for the delivery of 60 billion lire ($105 million) worth of capital equipment from Italy over the three year period, manufactured from raw materials to be delivered by the U.S.S.R. 2/ According to the Soviet communique, payment for value added is to be largely by additional grain deliveries.

Should this trade be substantially carried out, and assuming the continuation of U.S. export control in its present aspects, Italy may supersede the U.K. as the Soviet Union's foremost trading partner outside of Eastern Europe. Italy would account for, possibly, one-seventh or more of prospective Soviet trade with the western world.

Barring political obstacles, the chances for a high degree of implementation of this trade agreement may be characterized as good. The interest of each country in the other's deliveries is high; Italian industry is especially

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1/ By contrast, the necessity to expand plant capacity for reparations production has been a serious problem in Finland, leading to inflationary and foreign exchange difficulties.

2/ Including 100,000 tons of cast iron, 75,000 tons of steel, and 100,000 tons of crude oil, copper, and nickel.

interested in additional orders for its underemployed resources. Italy and the U.S.S.R. enjoy a common tradition of trading in the face of apparent political divergences. This trade reached a peak in 1931, with Italian imports of $29.2 million, and exports of $14.4 million. Subsequently, the turnover declined, dropping to virtually zero in 1938. The Soviet export surplus with Italy was typical of Soviet inter-war trade with Europe (except Germany), when the U.S.S.R. sold grain, oil, and raw materials in Europe and bought capital equipment in Germany and the U.S.

While postwar Italo-Soviet trade has been quite small heretofore, 1/ a good economic basis exists for its expansion, as already indicated, and it may be expected to be more nearly balanced than in the inter-war period. Soviet purchasing of capital equipment abroad has been faced recently with increasing difficulties, the major one of which at present is U.S. export control. The placement of Soviet orders in Sweden and the U.K. has been much below the levels anticipated in the respective trade and credit agreements, owing largely to lack of interest in such orders in the two exporting countries. Other major sources of capital equipment are either well booked with production orders for the E.R.P. or have already accepted sizeable Soviet orders (Belgium, Switzerland). With the exception of Western Germany and Japan, Italy seems to be virtually the only country with plant and labor now available to receive large-scale Soviet orders for capital equipment. Moreover, Italian ability to produce high quality ships, marine engines, electrical equipment, ball bearings, and other items seems to correspond well to present Soviet needs.

Italo-Soviet trade need not be limited to the provisions of the trade agreement. Significant in this respect is the accession of Italy to the "transferable accounts list" with respect to sterling on December 6, 1948. The Soviet Union has been on the "transferable accounts list" since December 1947, and has shown an increasing tendency to conduct its foreign trade on a sterling basis.

What has been already said about the effect of the reparations agreement on the employment of Italian labor and plant capacity is largely applicable, and in greater measure, to the trade agreement. In general, the agreement conforms to a pattern of East-West trade that may be considered very desirable from the point of view of Western European economic recovery. The longer-term possibility of regaining a large Eastern European market for industrial products is of especial interest.

1/ Italian statistics show (in millions of dollars) for 1947: imports -- 2.7, exports -- 1.2; for the first six months of 1948: imports -- 2.1, exports -- 1.0 (official statistics, converted at 575 lire to the dollar).

The increasing reappearance of Soviet timber in European markets is also to be welcomed in view of the present tight supply situation in this line. However, the agreement should not be credited with making the particular quantity of Soviet grain available to Western Europe, as the Russians have given indication of being quite eager to market abroad their exportable quantities of grain.