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CENTRAL BANK POLICIES AND THE DISEQUILIBRIUM IN THE GERMAN ECONOMY

J. Herbert Furth

For more than a year, the development of the German economy has disappointed the Allied as well as the German authorities. Germany is at present the only major industrial country in Western Europe where industrial production and foreign trade has remained substantially below the level of 1937. This lack of sufficient progress, doubly puzzling after the astonishing upswing which followed the currency conversion of June 1948, indicates deep-seated disequilibrium.

Germany, however, has not shown a clear-cut inflationary nor a clear-cut deflationary trend, which would explain the persistence of disequilibrium. In 1949, currency in circulation increased by 1.4 billion marks and deposits with commercial banks (excluding inter-bank deposits) and short-term commercial bank credits increased by 4.0 billion marks each, while the government budget, which previously had been in balance, is now showing an increasing deficit. These factors, as well as the rising level of production and of imports, seem to indicate some inflationary tendencies. On the other hand, employment has declined, unemployment has tripled, reaching a record level of almost 2 million, and investment has expanded far less than would be necessary to reach the targets of the European Recovery Program. These factors, in addition to a slight drop in the price level, seem to indicate some deflationary pressure.

The trouble apparently is caused more by the inflexibilities inherent in the German economy than by the over-all ratio between the supply of money and credit, and of goods and services. The existence of such inflexibilities is not astonishing. The repair of war damage has proceeded at a very unequal pace, and has brought about excess capacities in some industries with bottlenecks in others. The problem of housing has not yet been solved but, in fact, has been aggravated by the inflow of refugees. Mobility of labor has thus been severely curtailed. Another factor in the persistence of disequilibrium has been the direction of investment. Generally it has gone to those industries which promise the highest returns in the short run or to those that command sufficient means to provide for self-financing.

Assuming the existence of certain serious inflexibilities, the difficulties of the German economy cannot be relieved by outright inflationary or deflationary measures nor by the reimposition of direct controls. New purchasing power in the form of credit or currency would simply extend the sector in which inflationary pressures are to be found and lead eventually to renewed open inflation. Similarly, an over-all reduction in credit or currency would merely extend the area in which deflationary pressures already exist and thus aggravate the stagnation in investment and employment. Finally, the use of direct controls, while possibly avoiding inflationary or deflationary consequences, would tend to perpetuate the present disequilibrium instead of leading to an equilibrating adjustment of the economy.

The solution of the problem, therefore, should be reached by changes in the flow rather than in the volume of money and credit. This should be brought about by measures which utilize the mechanism of the market economy and do not try to replace the market system by centralized planning.

In this connection, central bank policies, involving changes in the structure of interest rates as well as in the functions of commercial banking and of the capital market, may prove indispensable. These policies may have to depart somewhat from certain general principles of banking, which are appropriate in normal situations but would unduly hamper the work of rehabilitation under the special conditions prevailing in Germany today. In particular, some traditional concepts of the relation of central and commercial banks to long-term investment credits and of the ratio between short-term and long-term interest rates may have to be revised, at least for the period of postwar transition.

Simultaneous contraction and expansion of credit

To the extent that the German economy is suffering from inflation, the trend can be counteracted by measures hampering further expansion of short-term credits. These credits largely finance the budget deficit, the importation of consumers' goods, and probably some commodity and currency speculation. The obvious way to stop such expansion is to raise the interest rates on such credits and to narrow the limits of rediscounting for government and short-term business paper.

On the other hand, to the extent that the German economy is suffering from deflation, the remedies are less simple. The situation is particularly complex because the insufficiency of investment, which apparently is mainly responsible for the disequilibrium, is due neither to a lack of ample investment outlays (like in stagnant economies) nor to bottlenecks in commodities or manpower (like in underdeveloped areas).

It is frequently contended that the insufficiency of investment is due to the insufficiency of savings. However, the increase in the volume of bank deposits appears to contradict this explanation. More than four-fifths of the rise in 1949, or about 3.3 billion marks, represented an increase in the deposits of private individuals and enterprises, and more than half of the total increase, or about 2.0 billion, concerned time and savings deposits. The insufficiency of investment seems therefore to have been due not to the volume but to the direction of new savings. It appears that savings were used for increasing bank deposits rather than for purchasing securities, since the German people in 1949 bought only 0.7 billion marks of new bonds and a negligible amount of new shares. Also, the bank deposits swelled by those savings were used by the banks for short-term rather than for long-term advances.

If all the new savings had been used for investment purposes, capital formation financed by such private funds in 1949 would have amounted to 4.0 billion instead of 0.7 billion marks. Such an increase, added to the self-financed investments and to those financed by counterpart and other public funds, would have made possible decisive progress toward equilibrium. Under the present political and economic circumstances in Germany, however, it seems impossible to induce the public to channel its savings to the bond and share market rather than to bank deposits. Although confidence in the currency has been increasing, the uncertainty of future development still produces a high liquidity preference, and the memory of the great depression deters the small capitalist from acquiring corporate shares. The only way to channel savings into long-term investments, therefore, appears to be for the banks to devote their deposits as far as possible to long-term rather than short-term uses.

In this connection, the anti-inflationary measures advocated above acquire a new meaning. Short-term credits and credits financing a current government deficit in general should indeed be made more difficult and more expensive; but at the same time long-term credits should be made easier and cheaper. Central bank refinancing of short-term and government paper should indeed be restricted, but at the same time it should be expanded for the use of long-term advances and new securities. Interest rates should indeed be raised for short-term and government credits, but at the same time they should be lowered for long-term investment loans.

Objections to proposed policies

All these measures seem to contradict some of the most cherished principles of banking. It is true that liquidity would require short-term rather than long-term investment. Generally speaking, however, the banks can count on a net withdrawal of only a small fraction of their deposits and it would be sufficient to keep only a fraction of bank assets invested in short-term assets -- with even a smaller fraction to be kept in assets of highest liquidity. Under these circumstances, it might be possible to divert a considerable part of the total to long-term investments. Only in times of extraordinary mass withdrawal of deposits would such a policy lead to difficulties. Mass withdrawal of deposits, however, would produce a strong deflationary pressure. In that case, it would not only be appropriate but indeed necessary for the central bank authorities to offset the deflationary impact of a reduction in deposits by an increase in the volume of currency. The central bank authorities should, therefore, be prepared to assist the commercial banks that may be threatened by mass withdrawal of deposits, and if necessary, enable them to pay out any amount of cash regardless of the liquidity of their assets. The establishment of an institution comparable to the Federal Deposit Insurance Corporation would give the banks and the public moral as well as legal certainty of such support. In the absence of such a corporation, a declaration of the central bank, which would offer unlimited rediscount privileges for long-term assets in the case of bona fide need, would probably be sufficient to satisfy bank managers and depositors.

There may be objections to the fact that such a channelling of deposits for uses not intended by the depositors would constitute undue interference of the government in business affairs. The typical depositor, however, would probably object to the banks making long-term investments only if they threatened the liquidity of his deposits. If it is made clear that the investment does not reduce liquidity of the individual deposit because that liquidity is guaranteed by the central bank, the depositor might well prefer that his funds be used for necessary investments rather than for unnecessary, and indeed harmful, expansion of short-term credit. There probably is not a depositor in Germany today who does not recognize the need for more investment. The fact that he does not want to take the liquidity risk of such an investment himself does not seem a sufficient reason for forcing the banks to act against the interests of both the economy at large and the depositors themselves. Moreover the typical depositor certainly prefers the use of his funds for investment purposes to an increase in direct investment by the government, which would lead to further increases in taxation and to more comprehensive government control over the economy.

Even under the most orthodox banking methods, complete liquidity is impossible. No bank could ever withstand a mass withdrawal of deposits without outside aid, even if all its assets consisted of short-term trade bills. This situation is particularly acute in the case of savings institutions, where the liabilities are deposits on, say, six months' notice, while many of its assets are claims with a maturity of as much as 20 or 30 years. Conditions which are accepted without question in the field of savings banking might well be extended to the field of commercial banking, provided that the special circumstances of the case seem to require drastic policies and that the depositors are protected by appropriate policies of the monetary authorities.

The channelling of bank deposits into long-term investment does not mean that the commercial banks should replace indefinitely the capital market as a source of funds. With the return of equilibrium and prosperity, the confidence of the public in the economy will increase and roundabout methods of financing investment will become unnecessary. In that case, the central bank authorities would be expected to reestablish the usual refinancing requirements, and thus confine the commercial banks again to short-term operations. Furthermore, it would not be necessary to tie up bank funds in an indiscriminate manner. The staggering of maturities, a device used by all investment bankers to assure a steady reflow of funds, would make it possible to redirect continuously a proper fraction of the invested amount to new and better use. Such a staggering of maturities would also simplify the task of the central bank authorities, and enable them to maintain the necessary flexibility of their refinancing policies.

These policies were not shown to be impractical by the events leading to the world-wide banking crisis of 1931-33. At that time, the central banks were not prepared to guarantee commercial bank deposits -- although in many countries the authorities were forced to supply belated guarantees after the mass withdrawal of deposits had reached alarming proportions. More important still, commercial banks in many countries had to use foreign short-term deposits for long-term investments. Such a use could never be justified since the central banks, while able to furnish domestic currency in unlimited quantities, usually cannot produce unlimited amounts of foreign exchange. The danger of foreign lending on short-term has meanwhile been so well understood that such abuses are not so likely any longer.

Moreover, the proposed policies would be appropriate only under exceptional circumstances such as exist in Germany today. In general, the strict separation of short-term and long-term credit transactions has obvious advantages. This separation should be abandoned only at a time when within a particular country the ordinary capital market has ceased to function and cannot be revitalized fast enough to avert disastrous economic and political consequences of chronic underinvestment and under-employment.

Interest rate structure; conclusions

The change in the structure of interest rates, implying long-term rates substantially lower than short-term rates, would reestablish a relation which was by no means unusual before the Great Depression. In the United States for instance, first-rate corporate bonds frequently showed lower yields than prime commercial paper: 6.12 per cent as against 7.50 per cent in 1920, 5.97 per cent as against 6.62 per cent in 1921, 4.55 per cent as against 4.85 per cent in 1928, and 4.73 per cent as against 5.85 per cent in 1929.[1]

The main technical difficulties of such a situation would be caused by borrowers trying to use long-term borrowing for short-term purposes, or to put their own funds to short-term and borrowed funds to long-term uses, in both cases reversing the usual procedure without increasing the total amount available for long-term investment. The first of these abuses could be prevented by a system of "end-use controls" similar to that enforced by international lending agencies. The second abuse could be minimized by a proper selection of debtors, say, by refusing credits to very liquid and not merely to illiquid prospective borrowers.

The banks might attempt to sabotage the policy by foregoing rediscounting and continuing the use of their own funds for short-term advances, in order to increase their profits. However, proper cooperation

1/ Banking and Monetary Statistics, pp. 448 and 468.

between the central bank authorities and the commercial banks would make large-scale evasion unlikely. At worst, a change in the reserve requirements might have to be considered, forcing the banks to make available a fraction of their funds for long-term purposes.

It would also be possible to channel bank deposits indirectly into investment, by letting the banks underwrite short-term or medium-term paper of special long-term investment institutions like the government-owned Reconstruction Loan Corporation. Such a procedure might cater to the prejudices of bankers and depositors; but, apart from its inherent insincerity, it would concentrate overwhelming power and responsibility in the hands of the Reconstruction Loan Corporation. That corporation has already sufficient influence and responsibility, through its disbursement of counterpart and other public funds. The future development of the German economy would be seriously threatened if investment were made a virtual monopoly of a government-controlled institution.

The measures outlined above alone will not solve all problems of German finance. The difficulties caused by war, occupation and partition, by the inflow of refugees, and especially by the deficit in the balance of current international payments, cannot be overcome by financial measures only. However, these measures may help to eliminate the disequilibrium which has resulted from the vicious interplay of inflationary and deflationary forces, and thus assist in putting the German economy on a sounder financial basis. This would help to complete the work of stabilization begun with the currency reform of 1948. Germany would then join other major European industrial nations which, while still having difficulties in their relations with the dollar area, are well on their way back to equilibrium in their total foreign trade as well as in their domestic economy.

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REVALUATION OF THE RUBLE

J. Herbert Furth and
Gordon B. Grimwood

On March 1, 1950, the Soviet Government announced that the ruble had been detached from the U. S. dollar, to which it had been pegged in July 1937 at the rate of 5.3 rubles per dollar, and had been put back on a gold basis. One ruble was now to be equal to 0.22168 grams of gold, which meant a dollar parity of 4 rubles per dollar and an upward revaluation of the ruble, in terms of dollars, by 32.5 per cent. The new rates for other currencies are based upon their official gold or dollar values.

The Soviet Government announced at the same time a cut in the prices of many consumers' goods, ranging from 10 to 30 per cent. In conjunction with other price cuts which followed the currency reform of December 1947, this change reportedly brought prices down to about two-thirds of the 1947 level. Actually, the price cuts had no economic connection with the appreciation of the ruble but Soviet propaganda has consistently linked these two actions together.

Purchasing power of the ruble

The Soviet authorities assert that the revaluation of the ruble was justified by the drop in Soviet prices and a rise in world market prices in terms of dollars. Actually, however, the purchasing power of the ruble is substantially lower than that of the dollar even at the pre-revaluation ratio. The table on the next page compares the prices of some important consumers' goods in the Soviet Union and the U. S., and indicates the resulting "purchasing power parity namely, the ratio of Soviet and U. S. prices. It shows that parity would require a rate of at least 20 rubles per dollar, and that the ruble is therefore overvalued by at least 300 per cent at the new official quotation.

In comparing these figures, it should be remembered that the various items have a very different importance for Russian and American consumers. Russians, for instance, prefer black bread while Americans prefer the white variety and for this reason the Soviet authorities apparently have kept the price of black bread reasonably low. On the other hand, some of the semi-luxury items like wrist watches, which seem to be priced below average, are hardly within the reach of the average Russian consumer. The quality of many Russian goods is certainly below American standards; this magnifies the discrepancy in purchasing power over and above the data revealed by the unadjusted figures.

Any comparison of the purchasing power of a Soviet currency with that of non-Soviet money should take into consideration the fact that in a Soviet economy probably more than half of the retail price represents the "turnover tax", which finances virtually all government expenditures, including a large part of the economy's investments. In a non-Soviet economy, these expenditures are primarily taken out of the consumers' income by means of direct taxes and voluntary saving, which reduce effective demand and thus the retail price level. The difference between the purchasing power of the ruble and that of the dollar (at the official rate), however, is so large that even a correction for that discrepancy does not fundamentally alter the result.

Comparison of Prices in Soviet Union and United States
(As of March 1, 1950)

| Commodity | Unit | Soviet Price (rubles) | U. S. Price (dollars) | "Purchasing Power" Parity 1/ (rubles per dollar) |
|---|---|---|---|---|
| Food: | | | | |
| Bread, black | Pound | .80 | .17 | 4.7 |
| Potatoes | " | .40 | .05 | 8.0 |
| Milk | Quart | 3.84 | .19 | 20.2 |
| Bread, white | Pound | 2.72 | .12 | 22.7 |
| Beef (for soup) | " | 9.56 | .39 | 24.5 |
| Butter | " | 20.00 | .68 | 29.4 |
| Pork | " | 16.60 | .45 | 36.9 |
| Sugar | " | 5.80 | .10 | 58.0 |
| Other Consumer's Goods: | | | | |
| Wrist watch | Each | 400.00 | 30.00 | 13.3 |
| Portable typewriter | " | 998.00 | 63.40 | 15.7 |
| Woman's suit | " | 515.00 | 25.00 | 20.6 |
| Cigarettes | Pack of 25 | 4.32 | .19 | 22.7 |
| Silk stockings | Pair | 32.00 | 1.29 | 24.8 |
| Table model radio | Each | 1,088.00 | 38.95 | 27.9 |
| Man's suit | " | 1,109.00 | 27.00 | 41.1 |
| Woman's dress | " | 444.00 | 8.95 | 49.6 |
| Man's shoes | Pair | 340.00 | 5.00 | 68.0 |
| Woman's shoes | " | 515.00 | 5.00 | 70.0 |

1/ Soviet price divided by U. S. price.
Source: Department of State, Office of Intelligence Research, Rpt.No. 5205, March 6, 1950.

The fact that the new rate, despite the price cuts, overvalues the ruble even more than the old one did is of considerable importance to the foreigners who are still permitted to travel in the Soviet Union. The members of the diplomatic missions of Western powers are hit even harder than private individuals, since the Soviet authorities have already unilaterally reduced the "diplomatic rate" from 8 to 6 rubles per dollar and have announced that the diplomatic rate will be entirely abolished after June 30, 1950. The economic effect of that change is lessened by the fact that most foreign diplomats have to import the bulk of their purchases from their home countries: these commodities were either unavailable or far more expensive in Moscow than at home, despite the added burden of transportation costs and in some cases tariff duties The change in the diplomatic rate will mainly affect expenditures such as rent and the wages and salaries of native employees. Altogether, it is to be interpreted as another unfriendly gesture toward foreign diplomats rather than as a measure of economic policy.

Communist ideology and the gold standard

In theory, a return to the gold standard would be in line with orthodox Marxist economics. Marx was, in this as in so many other points, a strict follower of classical economics. According to him"paper money is a token representing gold" and"the issue of paper money must not exceed in amount the gold (or silver) which would actually circulate if not replaced by symbols." An over-issue of paper money would raise prices so that eventually the total amount of paper money in circulation would still "represent only that quantity of gold which, in accordance with the laws of the circulation of commodities, is actually required and is alone capable of being represented by paper." 1/

Originally, the Marxian laws of the gold standard were considered valid only for a capitalistic and not for a communistic economy. However, it is accepted Soviet theory that in the "socialist" stage of transition, in which the economy of the Soviet Union is at the present time, the "laws of value" of the capitalistic economy remain largely in force. Accordingly, Marxist economics seem to require that the Soviet Union have a currency based on gold. This ideology may in part have been responsible not only for the reestablishment of a formal gold parity, but also for the stress put on gold production and accumulation by the Soviet authorities in past years. In the interwar period, annual output of gold reached an estimated 5.4 million ounces in 1937, as compared to the pre-Soviet peak of 1.7 million ounces in 1910. Output, at present, is variously estimated at between 4 and 7 million ounces annually. 2/ Whatever figure may be correct, there can be no doubt that Soviet gold holdings, at the price of $35 per ounce, have reached the equivalent of several billion dollars.

This emphasis on an increase in gold output is particularly noteworthy because the cost of production, converted at the old rate of 5.3 rubles per dollar, has been estimated at approximately 7 to 8 times the price of gold. 3/

1/ Marx, Capital, ed. Dent, pages 108-109.
2/ International Monetary Fund, Estimates of Russian Gold Production.
3/ Gregory Grossman, The Soviet Economy in 1949 - I, (this Review, May 9, 1949), page 10.

Gold production is carried on mainly by forced labor, 1/however, and the "opportunity-cost" of the use of that labor may be much smaller than its money cost. Still, it might be possible to use forced labor even in Siberian penal camps for more productive purposes, such as lumbering, and in fact such a diversion was apparently practiced during the war.

The accumulation of large gold holdings might also have been based upon the idea that gold could be used for the purchase of essential commodities at a time when normal trade relations might be interrupted by boycott or armed conflict. If this interpretation were correct, Russian gold production would form part of a system of war preparation. However, such an explanation would imply that the Soviet planners are overlooking the sad experience of the Nazi authorities in their vain attempts to exchange substantial sums of looted gold for commodities during the recent war. It seems more likely that the emphasis on gold production and the formal re-establishment of a gold standard are both largely influenced by Marxist ideology.

Since cost considerations play a significant role in Soviet planning, the increase, resulting from the new gold price, in the cost of producing gold might hamper further expansion, or might even lead to some curtailment of output. However, the gold production "subsidies" (probably included in the budget expenditures for the Secret Police, which runs the forced labor camps) represented already at the old official price about 88 per cent of the production cost while the sales proceeds covered only about 12 per cent. The relatively small change in the sales price cannot therefore have significant repercussions. The extent of gold production will probably be determined, just as in the past, by the decision to allocate a larger or smaller amount of subsidies.

Effect on the domestic economy

The pegging of the ruble to gold does not mean free convertibility of currency into gold. Such convertibility would be inconsistent with the principle of "directing the economy by means of the ruble." 2/ The injection of gold into the economy would introduce the possibility of currency speculation and especial hoarding: the Soviet authorities must be fully aware of that danger, if for no other reason than because it has been discussed by Marx. 3/ On the other hand, the Soviet economy needs, even more than a capitalistic system, the highest possible degree of stability in its monetary system. Since planning is largely based on value figures, a constant basis of these figures is indispensable for a successful execution of the plans, and especially for a workable control of plan fulfillment.

From a more pragmatic point of view, the need for stability has been demonstrated by the disadvantages which resulted from the inflationary movements before and in particular during the recent war. The currency reform of December 1947 was destined to put an end to inflationary tendencies once and for all, and the revaluation of the ruble may be interpreted as a dramatic statement of the complete success achieved in that struggle.

1/ Alexander Gerschenkron, Notes on Soviet Gold Output (this Review, July 27, 1948).
2/ For a discussion of the relation of monetary policy to Soviet economic planning, see Gregory Grossman, Steps Toward Monetary Stability in the USSR (this Review, November 22, 1949).
3/ Marx, Capital, pages 110-124.

The importance of public confidence in the currency for the maintenance of a stable monetary system explains the attempts of the Soviet propaganda to link the revaluation of the ruble with the cut in consumers' prices. It is possible that the Soviet authorities have managed in devious ways to reduce consumers' money incomes so as to prevent the cut in prices from raising real incomes. However, no such methods have so far become known, and therefore it seems probable that the real income of consumers actually has increased to the extent indicated by the price cut.

At the same time, no indications of renewed scarcity of goods have appeared and therefore it seems probable that the supply of consumers' goods has become sufficiently plentiful to stand the increase in effective demand resulting from the rise in real income. Available information is too scanty to permit any conclusion as to whether the rise in the output of consumers' goods, indicated by the larger supply, was greater or smaller than the increase in the production of capital equipment and armaments. In any case, the fact that the Soviet authorities have been induced to divert larger (absolute, if not also relative) amounts of factors of production to the consumers' goods industries may be interpreted in one of three ways: public dissatisfaction with the continued system of austerity may have been strong enough to force a change in plans; or a more optimistic view of the international situation may have induced authorities to shift some factors of production from war to peace uses; or the fulfillment of the production plans was so satisfactory that consumer demand could be given greater consideration without impinging upon capital investment and armament plans. The official Soviet explanation emphasizes the third interpretation; from the point of view of international peace, one should hope that the second interpretation would prove to be correct.

## Effect on international trade

The ruble is not traded internationally and there is no indication that the Soviet authorities intend to introduce it now into the international exchange market. Trade agreements between the Soviet Union and the non-Soviet world are based on dollar or sterling values and are therefore unaffected by the change in the ruble rate. It is true that the ruble value of exported and imported goods will now be about 25 per cent lower than before. However, this change will not be much greater than that which took place in domestic prices as a result of the recent price cuts but more important still, international and domestic prices have been completely separated in the Soviet economy and it is therefore unlikely that the change in the relation between domestic and international prices will have any influence on export and import plans.

From the point of view of Soviet accounting, imports will become slightly cheaper and exports slightly less remunerative. In view of the tremendous discrepancy between domestic Russian prices and world-market prices, however, even at the old exchange rate, these slight changes would make only a negligible difference. The size of exports and imports will actually be decided like that of gold production, by raising or lowering subsidies for exports and offsetting taxes on imports.

Aslong as the gap between international and domestic prices has not been bridged, there is no possibility of using the ruble in its capacity of a standard of domestic prices. It is possible that the Soviet authorities will insist for prestige purposes on expressing some or all international prices in rubles at the official rate of four rubles per dollar. Even if the trading partners of the Soviet Union permit such a use of the ruble, the action would be economically unimportant since it would merely mean a roundabout way of expressing those prices in terms of dollars.

## Effect on satellite nations

The Soviet authorities may try, however, to use the ruble revaluation for putting a further squeeze on their satellites. The importance of such moves must not be over-rated since the Soviet Union has already forced its satellites to concede terms of trade which are as favorable to the Soviet Union as possible without entirely wrecking the economies of the satellite countries. However, the Soviet authorities may intensify their attempts to purchase goods from the satellite countries at world prices, converted into rubles at the new exchange rate, while selling Russian goods at domestic prices. Such attempts may, for instance, be directed toward an acquisition of Rumanian gold at the new "parity" rate.

Some observers believe that the revaluation of the ruble is another step in the direction of economic integration of the satellite nations into the Soviet Union, and envisage the creation of a ruble area comparable to the sterling area in the free world.

Such a development is indeed possible and may well be planned by the Soviet authorities; however, it will require more than the establishment of a formal relation between the ruble and gold. The satellite countries can be incorporated into the Soviet economic system only if their price and income levels become adjusted to Russian standards. At present, prices at least in some of the satellites, and especially Czechoslovakia and Eastern Germany, still are somewhat closer to the world-market level (at official exchange rates) than to the Russian level. These prices (in satellite currencies) would have to be raised considerably, or the satellite currencies would have to be revalued considerably in relation to the ruble, in order to make the price level conform to the Russian standards. It seems unlikely that the Soviet authorities would want a sharp rise in prices, which might well lead to inflationary developments in the satellite countries; and it seems equally unlikely that they would want a substantial revaluation of satellite currencies in terms of the ruble since their recent propaganda barrage has interpreted changes in exchange rates to indicate the relative efficiency of the countries concerned. A rise in satellite currencies would, therefore, mean that the satellite economies were more efficient than the Russian economy, and such a confession would be impossible in the Soviet sphere.

It seems more likely that the Soviet authorities will insist upon further loosening of the ties between the satellites and the West, rather than upon an immediate integration of the satellites into the Russian economy. The withdrawal of Poland from the International Monetary Fund and the International Bank for Reconstruction and Development may be an example of Soviet policy. It should not be astonishing if Czechoslovakia followed suit; for instance, a Fund refusal of a possible Czechoslovak request for changing the par value of the Czechoslovak crown in accordance with the recent revaluation of the ruble — which would keep the pre-revaluation rate between ruble and crown unchanged — might be taken as an excuse for withdrawal. Czechoslovakia, in contrast to Poland, could not base a withdrawal upon the assertion that it had not received assistance from the Bretton Woods organizations.

The Soviet authorities may try, however, to introduce the ruble in Soviet China. The Chinese currency situation is still very confused, and the fact that the recent economic agreement between the Soviet Union and Soviet China expressed all values in terms of U. S. dollars, probably was felt to be a blow to the prestige of the Soviet world. A radical currency reform probably will be introduced as soon as the financial rehabilitation of Soviet China has made sufficient progress, and it would not be surprising if the new currency were pegged directly to the ruble.

Propaganda effect

In view of the limited economic significance of the revaluation of the ruble, it must be concluded that, apart from ideological reasons, the main practical purpose of the step was its propaganda value.

Domestically, the revaluation means that the Soviet authorities can now permit figures on U. S. wages — though not on U. S. prices -- to be published in the Soviet Union; Soviet wages, at the rate of four rubles per dollar, probably are somewhat comparable to U. S. wages, although Soviet prices still are not.

More important, the workers in Western Europe, plagued by continuous inflationary pressures and by the resulting devaluation of the Western currencies in terms of the dollar, may be convinced that the Russian policy was preferable to that of their non-communist governments. While few if any workers in Western Europe believe that the Russian worker is better off than they are, they may consider that their own standard of living is deteriorating while that of the Russian worker is improving.

Most important, however, may be the effect upon workers in underdeveloped nations, especially in the Near East, Southern Asia, and Africa. The standard of living of these workers may actually not be far below that of the Russian worker, and in any case their knowledge of economic conditions is so scant that they have no way of analyzing critically the Soviet contentions. They may be, therefore, more easily impressed by alleged demonstrations of the strength of the Soviet economy and of the rising real income of the Soviet worker.

These considerations are serious enough to make the Soviet move a significant part of Soviet strategy in the struggle against the West. It will be important to counteract the propaganda value of the move, mainly by impressing the world with the complete untruth of the Soviet contention that the ruble is "really" worth 25 cents. This counter-propaganda will have to be based upon a careful comparison of prices and, if possible, wages, and put into a language understood by economic laymen and especially by the workers, not only in developed but also in backward areas.

The tremendous interest aroused by the ruble revaluation has been in itself a major victory for Soviet propaganda. If the Western powers know how best to use the truth, however, that very interest may turn the Soviet victory into a defeat.