PUBLIC AS OF JANUARY 1, 2009

L. 5. 2.
RESTRICTED

RFD. 136

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

REVIEW OF FOREIGN DEVELOPMENTS

April 11, 1950

Repercussions of Disinflation
By Robert Solomon . . . . 6 pages

Developments in the Coffee Market and Their Implications for Latin America
By Ernest C. Olson . . . . .11 pages

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RESTRICTED April 11, 1950

REPERCUSSIONS OF DISINFLATION

Robert Solomon

A number of Western European countries have experienced a striking improvement in their balance of payments during the past year. For most of them this improvement consisted of an increase in exports that proceeded at a greater rate than the rise in imports. For some countries--such as Belgium-Luxembourg, France, Sweden, and Switzerland--the reduction in the deficit resulted from an increase in exports combined with a decline in imports. These developments coincided with or followed a reduction in inflationary pressures (or even the appearance of deflationary tendencies 1/) in most of the countries. Nevertheless fears have been expressed that the declining balance of payments deficits will tend to recreate the inflationary pressures which have only recently been overcome. It is the purpose of this note to evaluate this point of view.

Postwar inflation

Since the end of the war the countries of Western Europe have been faced with the twin problems of balance of payments deficits and domestic inflationary pressures. Both of these problems, to a significant extent, are the result of wartime destruction of capital equipment and losses of foreign assets; in addition, however, domestic inflationary pressures have in themselves been partly responsible for balance of payments deficits.

Thus in many of the countries the deficits may be regarded as consisting of two parts 2/: one representing the real shortfall in domestic production below what was urgently needed for consumption and investment and the other an excess of imports (and a reduced level of exports) the demand for which resulted from the fact that the consumer expenditures generated by the high rates of investment and by large wartime accumulations of liquid assets were higher than was justified by the quantities of consumer goods available at existing prices. As a result prices tended to rise, speculative hoarding of commodities was induced and the excess demand not only "spilled over" and attracted goods from abroad but also served to make the domestic market more attractive to potential exporters.

Thus in some of the countries there has been a causal relation between inflationary pressures and balance of payments deficits, quite apart from the loss of resources due to the war. Under these conditions an attempt to reduce the deficit by applying more stringent import controls would have aggravated the inflationary pressures by reducing the quantity of goods available relative to consumer incomes.

It does not follow from this, however, that a reduced balance of payments deficit (or an increased surplus) is always inflationary. Fears have recently been expressed that the efforts of the ERP countries to eliminate their deficits during the next two years will exert an upward pressure on prices. This view may spring from the earlier postwar experience during which the Western European economies adjusted to inflationary

1/ See "Recession in Belgium," This Review, April 12, 1949.
2/ See A. O. Hirschman, "International Aspects of a Recession," American Economic Review, December 1949, p. 1252.

pressures by increasing deficits. It may also result from a mechanical interpretation of income analysis whereby an export surplus is regarded as an automatic expansionary force.

Disinflation and the balance of payments

Actually, an import surplus may decline (or an export surplus increase) as a result of a reduction of inflationary pressures (or an increase in deflationary pressures). In such circumstances, the reduced deficit tends to cushion the decline in the ratio of effective demand to available supplies at existing prices, but it should not be regarded as an independent, positive, expansionary force. 1/

A number of European countries in the past year have experienced a sharp reduction in inflationary pressures accompanied by a rapid improvement in their balance of payments positions. These experiences can be explained by a reduction in domestic effective demand for consumer and capital goods (including inventories) relative to the available supplies of such goods. 2/ As a result imports tended to decline relative to exports. But the latter effect was a consequence of a decline in the demand for goods relative to supply and could not normally be expected to re-create inflationary pressures.

To demonstrate this point, it will be useful to begin by examining separately the effect of a reduction in effective demand on imports and on exports. Insofar as imports are concerned, they will decline by less than domestic effective demand as long as some of this demand falls on home produced goods. That is, as long as the marginal propensity to import is less than one, imports will fall by less than effective demand. Thus if the entire improvement in the balance of payments position were caused by a reduction in imports 3/, this improvement could not entirely

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1/ Actually the difficulty may be expressed, as can so many other problems in economic analysis, as the confusion between a shift of a curve and a movement along a curve. The following analogy will illustrate the point. Consider a decline in consumer incomes, which leads to a decrease in the demand for consumer goods. If, as a result, the production of consumer goods declines, the effect is to cushion the fall of prices of consumer goods. Yet no one regards this reduction in the supply of consumer goods as an inflationary force, since the reduction in the amount supplied results from a movement of the equilibrium point along the supply curve as the demand curve shifts to the left. On the other hand, prices would have risen along the demand curve if supply had been reduced and the level of consumer demand had not changed. The latter case is analogous to the tightening of quantitative import controls while the former example corresponds to the result of anti-inflationary fiscal and monetary policies which affect demand.

2/ Actually both effective demand and availabilities may have been rising but the latter at a more rapid rate than the former.

3/ Resulting from a decline in demand rather than the application of quantitative import restrictions.

offset the decline in effective demand, under the quite reasonable assumption that the marginal propensity to import is less than unity.

Effect on exports

We are concerned with an economy in which open or repressed inflation is being eliminated, primarily as a result of a decrease in effective demand relative to the supply of goods available to the economy. The stabilization thus achieved is accompanied or followed by a reduction in the balance of payments deficit. The problem is: will the reduced deficit recreate the inflationary conditions which formerly were at least partially responsible for the existence of the deficit?

In examining the effect on exports, it may be assumed for our purposes that the level of foreign demand is not increasing. This assumption is justified in order that attention may be focussed upon the effects of a decline in effective demand in a particular country. If demand from other countries were rising the exports of the country in question would tend to rise even in the absence of a reduction in domestic demand.

If it is first assumed that domestic prices do not fall, it may be seen that the drop in demand leads producers to attempt to maintain their sales by selling more in foreign markets. That is, producers will undertake the additional effort and even additional costs 1/ involved in selling abroad in order to prevent their sales from falling off. But since many of the domestic goods and services, the demand for which has declined, are by their very nature not exportable, it is unlikely that increased foreign sales will completely offset the reduction in domestic effective demand.

Assuming now that marketing conditions are sufficiently competitive so that the export and domestic prices for the same product are identical, we must investigate the case where the price level falls as a result of the drop in effective demand. As prices fall, exports may be assumed to rise. We are now faced with the paradoxical question, when is a fall in prices inflationary? A situation can be imagined where foreign demand is so elastic that as prices fall in country A, its export proceeds increase to such an extent that domestic money incomes tend to rise despite the initial drop in domestic demand and prices. As a result, inflationary pressures would increase. For this phenomenon to occur it would again be necessary that exports be large relative to the total output of goods and services.

If the process described in the previous paragraph began from a situation where output was at full capacity, the increased money incomes would tend to reverse the downward movement of prices. It can be shown 1/ that a necessary, though not sufficient, condition for this result to occur is that the foreign elasticity of demand for the exports of the country be greater than the ratio of its national income to the value of its exports. For most Western European countries the latter ratio is

1/ This implies a reduction in export prices or in the profits of exporters.
2/ See Appendix.

between 3 and 6. Since the elasticity of demand for exports is unlikely to be this high, it may be concluded that a drop in effective demand will probably be accompanied by a fall in money incomes, despite an improvement in the balance of payments.1/

Our previous reasoning makes it clear that even the combined effect of a decline in imports and an increase in exports will not be able to set inflation in motion again. We assume a fall in effective demand. This leads to a reduction in purchases of both domestic and imported goods. At the same time, the domestic producers who are affected by the decrease in demand endeavor to increase their foreign sales as domestic sales fall off. If foreign sales could be increased by an amount equal to the decline in sales of domestic goods, the entire fall in effective demand would be offset. It is probable, however, that some of the domestic goods for which demand is reduced are not exportable, so that a complete offsetting is not possible. For the case of a drop of prices resulting from a decline in demand, it has been shown that the conditions necessary for an offsetting to occur are not likely to be fulfilled.

It should be emphasized that this paper does not imply that inflationary pressures cannot be transmitted from abroad. It only maintains that an improved balance of payments resulting from a reduction in domestic inflationary pressures will not, in and of itself, recreate the same degree of inflation as existed before.

The assumptions and limitations of the above analysis should be clearly kept in mind. It is assumed that domestic effective demand is reduced for one reason or another; then the effects, both external and internal are traced out. It is also assumed, however, that these effects, for example an increase in exports, do not have repercussions beyond their immediate effect on effective demand. If, for example, increased exports in some lines of output led producers of those goods to raise the level of investment, and investment elsewhere did not decline, the results outlined above would not materialize.

While the argument presented in this note assumes that a reduction in effective demand will lead to a reduction in the balance of payments deficit, it is not intended to imply that such a result is a necessary consequence of internal deflation. This stricture is especially relevant in a situation where a number of important trading countries are simultaneously experiencing deflation, since, under these conditions, the improvement of each country's foreign balance would react unfavorably on the balance of payments of the others, and the outcome for any individual country would be entirely uncertain.

1/ It may be convenient to think of the foreign elasticity of demand for the whole output of a particular country as a weighted average of elasticities for different products. For some commodities and services, those referred to above as not exportable, the elasticity is zero. The smaller the ratio of non-exportable products to total output (or, the smaller the ratio of national income to the value of exportable products), the smaller need be the foreign elasticity of demand for exports, in order that a drop in domestic demand be offset by increased sales abroad.

Let C = real consumption plus investment
E = volume of exports
M = volume of imports
P = price level
Y = money national income

Then, $Y = P(C + E-M) = PC + PE - PM$ (1)

Assume that the quantity of imports is a linear function of real consumption plus investment,

$$M = sC - b, \qquad (2)$$

where s represents the marginal propensity to import.

Assume that the price level is a function of domestic demand (C), and express the relationship as an elasticity, n,

$$\frac{\frac{dP}{P}}{\frac{dC}{C}} = \frac{C}{P} \cdot \frac{dP}{dC} = n \qquad n > 0 \qquad (3)$$

Assume that exports are a function of the price level, expressed as the elasticity of foreign demand for exports,

$$\frac{\frac{dE}{E}}{\frac{dP}{P}} = \frac{P}{E} \cdot \frac{dE}{dP} = -k \qquad (4)$$

We are interested in the conditions under which money national income will rise as domestic effective demand (expressed as real consumption plus investment) declines. Thus the condition is,

$$\frac{dY}{dC} < 0 \qquad (5)$$

$$\frac{dY}{dC} = P + C\frac{dP}{dC} + P\frac{dE}{dC} + E\frac{dP}{dC} - P\frac{dM}{dC} - M\frac{dP}{dC} < 0$$

Rewriting this expression and noting that $\frac{dE}{dC} = \frac{dE}{dP} \cdot \frac{dP}{dC}$ and that $\frac{dM}{dC} = s$,

$$P + \frac{dP}{dC}(C + E-M) + P\frac{dE}{dP} \cdot \frac{dP}{dC} - P.s < 0$$

Dividing by E and noting that $C + E - M = \frac{Y}{P}$,

$$\frac{P}{E}(1-s) + \frac{Y}{PE} \cdot \frac{dP}{dC} + \frac{P}{E} \cdot \frac{dE}{dP} \cdot \frac{dP}{dC} < 0$$

But, $\frac{P}{E} \cdot \frac{dE}{dP} = -k$

Therefore, $\frac{P}{E}(1-s) + \frac{Y}{PE} \cdot \frac{dP}{dC} - k\frac{dP}{dC} < 0$

Multiplying by $\frac{C}{P}$ and denoting $\frac{Y}{PE}$, the ratio of national income to the value of exports, by r,

$$\frac{C}{E}(1-s) + \frac{C}{P} \cdot \frac{dP}{dC}(r-k) < 0$$

But $\frac{C}{P} \cdot \frac{dP}{dC} = n$,

Therefore, $\frac{C}{E}(1-s) + n(r-k) < 0$

Or,

$$n(k-r) > \frac{C}{E}(1-s),$$

$$k-r > \frac{C}{nE}(1-s)$$

and,

$$k > r + \frac{C}{nE}(1-s).$$

Neglecting the second term on the right for the moment, it may be concluded that a necessary, though not sufficient, condition for a decline in domestic effective demand to result in an increase in money national income is that the foreign elasticity of demand for exports (k) be greater than the ratio of national income to the value of exports (r). For most Western European countries this ratio (r) is between 3 and 6, and it seems unlikely that the elasticity of foreign demand would exceed this magnitude.

On the other hand, if k is not greater than r, the only other way in which the inequality can be satisfied is that s, the marginal propensity to import, be larger than unity. This is even more unlikely.

Assuming that s is smaller than one, it may also be noted that the greater n is--that is, the greater the response of domestic prices to a decline in effective demand--the smaller need be the foreign elasticity of demand to satisfy the inequality, but in any case it must be greater than r.

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April 11, 1950

DEVELOPMENTS IN THE COFFEE MARKET AND THEIR IMPLICATIONS FOR LATIN AMERICA

Ernest C. Olson

During the summer months of 1949 coffee prices rose slowly and in the closing months of the year advanced spectacularly to record levels. The principal advances occurred during October and November when New York average spot prices of Brazilian coffee known as Santos 4's rose from 30.2 cents per pound in September to 49.6 cents in November. During the same period, New York average spot prices of Colombian Manizales coffee rose from 35.7 cents to 54.3 cents per pound. By the end of January 1950, prices apparently were quite firm at or near their peak levels. Although prices have declined slightly in recent weeks, there seems to be some reason to believe that the new price level is likely to be maintained for some time to come.

The magnitude of the price rise and its apparent long-run nature has made the prospects of the coffee-producing countries the most favorable in many years. If present estimates of future supply and demand conditions are moderately accurate, such areas, the most important of which are found in Latin America, should realize substantial benefits. The conditions which accompanied the recent increase in coffee prices are quite different from those experienced in 1946 when the elimination of OPA controls led to an increase in coffee prices. At that time, the prices of most goods imported by the Latin American coffee producing countries also increased while today prices of these goods, at least in the near future, appear likely to remain generally at present levels. Thus, an increase in real income appears certain.

The prospective increase in real income accruing to these countries, if properly managed, affords them an opportunity to attain a degree of economic development while preserving or increasing levels of consumption. Most of these countries are either planning or executing investment programs designed to develop their economies. At the same time, with low levels of real income and consumption of the populace at near subsistence levels, great difficulties have been encountered in carrying forward a high rate of economic development. Where economic development has been aggressively pursued, the inherent conflict between these objectives has been reflected in rising inflationary pressures. Better control over the level of effective domestic demand could be used to allocate the increase in real income to appropriate areas of investment and consumption. The benefits to be anticipated from this development might well induce a larger flow of external credits from private, governmental or inter-governmental lending institutions. Thus, the higher level of real income in prospect for many of the Latin American countries is a challenge to the countries which stand to benefit by it and should be made the subject of careful consideration by their governments in the light of their economic policies and objectives.

Recent coffee developments

For nearly a decade, world production of exportable coffee has been substantially below pre-war levels, primarily because of poor crops in Brazil which normally supplies well over 50 per cent of world exportable production. Average yearly production of exportable coffee in Brazil declined sharply from

22.5 million bags[1/] for the period 1930-1940, to 13.3 million bags during the following five years. The estimate for the current year, 1949-1950, is 15.7 million bags. In addition to poor crops, this decline in production was due to a substantial reduction in the number of trees in existence in Brazil between 1934 and 1946. As of last year the number of Brazilian trees were estimated to be the same as in 1946. Production in Colombia, the second largest producer, has shown some tendency to increase during the last decade but this increase is small compared with the decline in Brazil's production. The exportable production of other producing areas in Latin America, and in Africa, Asia and Oceania have individually shown varied trends but little change collectively.

Unlike the trend in production, world demand for coffee has been rising steadily during the last decade. Total coffee imports of the major consuming countries increased more than 10 per cent during this period notwithstanding a substantial decline in European imports during the war. Since the end of the war, however, European imports of coffee have increased steadily, but are still considerably below pre-war levels. United States consumption, which amounts to about 75 per cent of world exportable production, has increased nearly 50 per cent since the beginning of the war and has more than offset the decrease in European consumption. Per capita coffee consumption in the United States has risen from a pre-war average of 14.4 pounds to more than 19 pounds in 1948. There can be little doubt that this increase in per capita coffee consumption is to some extent a reflection of the rise in real income which occurred during this period. Although quantitative verification is lacking, it appears that other factors, such as increased availability of properly brewed coffee in public eating establishments, changed dietary habits and institutional coffee advertising also contributed to this trend.

The upward surge in coffee prices last fall appears to have been due to reports of crop damage due to a drought in the coffee-growing areas of Brazil and the impending exhaustion of Brazilian coffee stocks by the middle of this year. The disappearance of these inventories will place the world's principal supplier in a current position for the first time in 20 years. Although little is known regarding visible stocks in other producing areas, they too are believed to be nearing exhaustion. It is possible that some additional supplies may be forthcoming from invisible stocks held by producers, reductions in port stocks required as working balances, and reduced domestic consumption. These sources might yield some 3 million bags, nearly all of which would probably originate in Brazil.

Estimated receipts from coffee exports

The sudden rise in coffee prices last fall and the prospect that prices will continue at comparatively high levels for some time to come has brought into view substantially larger cofffee receipts than were anticipated a few months ago.

1/ 132.3 pounds per bag.

Effect during 1949 - The amount of the increase in such receipts which exporting countries received in 1949 or are expected to receive in the current year is difficult to estimate accurately. Enough information is at hand, however, to serve as a basis for reaching general conclusions as to the probable magnitudes involved. As a whole, the effect of the recent price rise on 1949 coffee receipts of most of the Latin American exporting countries does not seem to have been of any considerable magnitude. The principal reason for this appears to be that the price increase occurred late in the year, after much of the current supply had been sold under futures contracts at the lower prices of preceding months. This is especially true of most of the Central American countries where futures contracts are made from 1 to 7 months in advance.

There is little doubt, however, that some coffee was sold at the new prices during November and December. It is estimated that the eleven principal coffee exporting countries[1] of Latin America together may have received additional receipts of $60-$70 million during 1949, principally from exports to the United States and other dollar areas. By far the largest share, more than three-quarters of the total of some $53 million, appears to have accrued to Brazil. The profits of Colombia, Mexico, Venezuela, and Guatemala appear to have been only $2-$4 million and those of the remaining countries even smaller. Estimates for individual countries are shown in Table I on the next page.

With the exception of Costa Rica and Nicaragua, which appear to have received no increase in coffee receipts in 1949, all of the coffee exporting countries experienced balance-of-payments benefits as a result of larger coffee receipts. In the case of Brazil, much, if not all, of the increase in coffee receipts served to offset reduced receipts from other exports. Colombia ended the year with a surplus of exchange receipts over sales of nearly $11 million, as a result of tighter import controls as well as increased coffee receipts.

Short-term outlook - During 1950 and probably for quite some time thereafter, annual coffee receipts appear destined to exceed those of 1949 by a very wide margin. At present high prices, coffee exports, which appear now to be in prospect for Latin America during 1950, can be expected to yield $450-$460 million more than last year's exports. Roughly three-fourths of this increase is expected to originate in trade with the United States and other countries of the dollar area. Estimates for individual countries, presented in Table II, reveal that Brazil and Colombia are likely to gain some $280 and $120 million, respectively. Much smaller increases appear to be in prospect for other Latin American producers. Venezuela, with prospective gains of $14 million, and Nicaragua with $11 million rank next to Colombia, while Guatemala, El Salvador, Costa Rica, Mexico and Haiti follow with individual increases of $5-$7 million.

1/ Brazil, Colombia, Venezuela, Mexico, El Salvador, Guatemala, Costa Rica, Ecuador, Nicaragua, Dominican Republic, and Haiti.

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Table I

Estimated Increase in Coffee Receipts of Principal Latin American Coffee Exporting Countries in 1949, due to rise in coffee prices (millions of dollars)

	Estimated coffee exports 1949 (millions of lbs.)	Estimated coffee receipts at actual prices 1/	Estimated coffee receipts at former prices 2/	Increase in receipts
Brazil	2561	$ 650	$ 597	$ 53
Colombia	716	222	220	2
El Salvador	158	43	42	1
Guatemala	120	37	33	4
Venezuela	69	20	19	1
Mexico	102	32	30	2
Haiti	60	15	13	2
Costa Rica	40	12	12	0
Nicaragua	15	4.0	4.0	0
Dominican Republic	32	9.5	8.0	1.5
Ecuador	22	5.5	4.8	0.7
Total		$1050.0	$982.8	$67.2

1/ Derived from actual value U. S. imports.
2/ Weighted average price January-September 1949, U. S. imports.

Note: Price quotations and quantitative estimates of exportable production were obtained from the Department of Commerce and from U. S. consular reports. New York spot prices were deflated 10 per cent to adjust for insurance, freight and commission payments which did not accrue to the exporting countries. In the case of Brazil, the price was also adjusted to represent the relative importance of the two principal types of coffee exported, Santos 4's and Rio 7's.

Two sets of prices were used to obtain estimates of the value of 1949 exports: (1) weighted average prices in effect during the first 9 months of the year in trade with the United States and (2) weighted average of actual prices reported for trade with the United States during the entire year. Estimates of coffee exports to all areas by each country in 1949 were then priced at these two prices and the resulting difference in value taken to be a rough approximation to the increase in coffee receipts due to the rise in coffee prices in October and November.

To obtain estimates for 1950 it was necessary to make certain adjustments in recognition of futures contracts entered into before the sharp increase in price last fall. For a few countries some information was available which indicated the percentage of the current crop that had been sold before the price rise. Comparable adjustments for other countries had to be made on the basis of general knowledge of the contract periods in each country. For these countries estimated exports for the early months of 1950 were priced at prices prevailing prior to or during the period when futures contracts were made. In general, exports estimated for the first quarter of 1950 were valued at prices lower than those prevailing after the increase of last fall, while for the remainder of the year exports were valued at the average prices prevailing during November, December and January, which were assumed to be representative of the new price level.

Table II

Estimated Increase in Coffee Receipts of Principal Latin American Coffee Exporting Countries, 1950 compared with 1949.

	Estimated coffee exports 1950[1] (millions of pounds)	Estimated value coffee exports 1950 (millions of dollars)	Estimated coffee exports 1949 (millions of pounds)	Estimated value coffee exports 1949 (millions of pounds)	Difference between 1949 and 1950 (millions of dollars)	Ratio, value of coffee exports 1950 t value in 194
Brazil	2315	$ 931	2561	$ 650	$ 281	143
Colombia	781	341	716	222	119	154
El Salvador	145	49	158	43	6	114
Guatemala	116	44	120	37	7	119
Venezuela	70	34	69	20	14	170
Mexico	76	37	102	32	5	116
Haiti	57	20	60	15	5	133
Costa Rica	40	17	40	12	5	142
Nicaragua	42	15	15	4	11	375
Dominican Republic	28	12	32	9.5	2.5	126
Ecuador	19	7.1	22	5.5	1.6	129
Total		$1507.1		$1050.0	$457.1	

1/ Based on latest available crop estimates and estimates of domestic consumption.

See explanatory note, Table I, for description of sources and methods used in estimating value of coffee exports.

Long-term outlook - The outlook for future years is more difficult to appraise. With real incomes in the United States at present or at higher levels, the United States demand for coffee probably can be sustained if not increased at present prices. For other consuming areas any attempt to estimate the future demand for coffee is necessarily subject to considerable error, because of direct governmental controls over coffee imports, purchases at negotiated prices under trade agreements, and the extent to which price changes affect consumption. Increases in coffee production, on the other hand, depend primarily upon the extent to which higher coffee receipts accrue to producers and the extent to which their profit, cost and price expectations and investment alternatives lead them to invest in the expansion of coffee production. According to a recent study by the International Bank,[1] world demand for coffee during the next decade is expected to rise from the recent level of 32 million bags to some 41 million bags. Production can probably be increased sufficiently to meet this level of demand for

1/ Paul N. Rosenstein-Rodan, International Bank for Reconstruction and Development, Increased Dollar Earnings and Coffee Inflation in Latin America.

the period as a whole. During the first five years, however, higher levels of production will depend primarily upon increasing the yields of existing trees, whereas later increases will depend heavily upon new plantings which must be undertaken in the near future in order to reach yielding age in the period 1954-59.

If the foregoing estimates of production and consumption are realized during the next decade, coffee prices will tend to remain near present levels. Should overplanting occur as it has in the past, or if demand should decline or not increase significantly, a period of oversupply and low prices might be reached in the late fifties.

Significance of increased coffee receipts

International position - The importance of foreign trade in the economic life of the principal Latin American coffee producing countries and the dominant position which coffee occupies in the exports of these areas makes any substantial change in coffee receipts of considerable significance to them. Coffee exports amount to 80 per cent of total exports in El Salvador, 77 per cent in Colombia and 62 per cent in Guatemala. In Costa Rica and Nicaragua, coffee exports comprise 45 per cent of the total, and in Brazil, 42 per cent. It is clear that for these countries coffee exports are a major source of foreign exchange receipts. Assuming that foreign exchange holdings could be increased by the full amount of the estimated increase in coffee receipts, it would mean an impressive proportionate change in international reserves. Under this extreme assumption, the gross foreign exchange holdings of Costa Rica and Colombia would more than double, Nicaragua's holdings would nearly quadruple while Haiti's would increase 90-100 per cent. Brazil's exchange holdings would increase approximately 40 per cent. Moreover, in the case of Brazil and Colombia, as well as several of the smaller producing countries, such increases would more than restore foreign exchange holdings to the unprecedented levels attained at the end of the war. In the case of Guatemala the increase would go far toward offsetting the decline in reserves experienced during the last year. These relationships for the principal Latin American coffee exporting countries are shown in Table III.

The extent to which the indicated increases in foreign exchange holdings will be realized depends, of course, on the extent to which international payments increase and upon independent factors determining exchange receipts. Some increase in foreign exchange holdings may be desirable in order to give these countries better protection against cyclical declines in world demand for their products. Furthermore, it may be desirable to accumulate additional foreign exchange reserves in those countries where a rapid acceleration in the rate of development could not be effectively managed. The increase in coffee receipts should permit substantial reductions in commercial backlogs, repayment of drawings from the International Monetary Fund and the payment of other international obligations which would be in the long-run interest of these countries to remit. On the whole, however, the increase in coffee receipts is significant primarily because it will permit an increase in imports of goods and services.

Brazil and Colombia are cases in point. A recent official estimate of the 1950 foreign exchange budget of Colombia indicates that the anticipated increase in coffee receipts this year is expected to provide most of the foreign

exchange needed for a scheduled increase in imports of 40 per cent. While it is understood that imports of essential goods will be emphasized, imports of non-essential goods will be subject to less rigorous restrictions as a result of the recent relaxation of controls over the import of such goods. By the beginning of the current year, Colombia's commercial backlog had been virtually eliminated. Brazil, on the other hand, began the current year with a substantial commercial backlog which has since been somewhat reduced, and an indebtedness to the International Monetary Fund of $37.5 million was incurred last year. If these obligations are met in full during 1950, a smaller proportion of Brazil's increased receipts will be available than is the case in Colombia for increasing imports.

Table III

Official Gold and Foreign Exchange Holdings in Relation to Increase in Coffee Receipts
(millions of dollars)

	Gross Gold and Foreign Exchange Holdings as of December 31					Gross Increase in coffee receipts 1950 compared with 1949	Ratio of increased coffee receipts to gold and foreign exchange holdings, December 31, 1949 %
	1945	1946	1947	1948	1949		
Brazil	674.1	770.1	795.2	766.1	724.4	281	39
Colombia	176.8	176.3	111.1	83.6	110.7	119	107
El Salvador	28.2	28.6	29.3	29.7	37.1	6	16.2
Guatemala	4.0	46.7	49.1	45.4	36.0	7	19.4
Venezuela	225.2	250.0	252.6	383.2	440.9	14	3.2
Mexico	299.3	196.7	114.1	n.a.	n.a.	5	--
Haiti	12.8	13.8	11.0	7.4	5.2 1/	5	96.2
Costa Rica	7.9	3.0	4.7	5.4	4.7	5	106
Nicaragua	6.7	6.4	5.4	3.4	3.8	11	289
Dominican Republic	11.6	15.2	13.5	14.8	15.1	2.5	16.6
Ecuador	33.1	36.5	26.6	27.9	26.5	1.6	6.0

1/ As of October 31, 1949.

Another measure of the significance of the increase in coffee receipts from the point of view of the international position of the coffee producing countries is the relationship between such receipts and the amount of loan disbursements to these countries which have been made by the International Bank and the Export-Import Bank. As shown in Table IV, all of these countries, with the exception of Guatemala, have received loans of a developmental nature from one or both of these institutions. The increase in coffee receipts during 1950 will provide Brazil with half again as much foreign exchange as has been disbursed to it by the above institutions. Colombia will experience increased coffee receipts which

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Table IV

Loan Disbursements of the International Bank and the Export-Import Bank in Relation to Increased Coffee Receipts
(millions of dollars)

	International Bank	Export-Import Bank		Total Disbursements	Estimated increase in coffee receipts, 1950 compared with 1949	Ratio of increased coffee receipts to total loan disbursements
	Disbursements through Dec. 31, 1949	Disbursements through Dec. 31, 1949	Disbursements by commercial banks at Export-Import Bank risk, through Dec. 31, 1949			%
Brazil	25.0	103.8	60.5	189.3	281	148
Colombia	0	23.2	22.1	45.3	119	263
El Salvador	0	1.5	0	1.5	6	400
Guatemala	0	0	0	0	7	—
Venezuela	0	5.3	2.7	8.0	14	175
Mexico	6.5	100.4	19.4	126.7	5	3.9
Haiti	0	10.7	0	10.7	5	46.7
Costa Rica	0	7.0	0.2	7.2	5	69.4
Nicaragua	0	4.0	0.7	4.7	11	234
Dominican Republic	0	3.0	0.3	3.3	2.5	75.8
Ecuador	0	13.3	0	13.3	1.6	12.0

are more than two and a half times the amounts received under such loans. Relative to credits received from these institutions, the increase in coffee receipts is also important in El Salvador and Nicaragua. It is clear that the prospective increase in coffee receipts during 1950 is high in comparison with the credits which the coffee producing countries have obtained from the International Bank and the Export-Import Bank.

Domestic position - The increase in coffee receipts will directly augment money incomes of those employed in coffee production and trade and will indirectly increase the money incomes of other sectors of the economy to a lesser extent. In the absence of current national income data, a rough indication of the internal significance of increases in coffee receipts is shown in Table V where such increases are compared with the dollar equivalent of the money supply in each country. Increased incomes resulting from larger coffee receipts may, of course, be spent on domestically produced goods as well as on imported goods and, therefore, the proper utilization of increased foreign exchange receipts is inextricably associated with the proper use of domestic productive resources. Depending upon the distribution of incomes and spending propensities, this increased income may be spent on luxury consumer goods or less essential capital investment. One of the major objectives of governmental policy, therefore, should be to control the domestic impact of the increased coffee receipts in a manner which will be consistent with economic policy objectives. For example, in order to offset the impact of higher coffee prices in countries where imports of goods and services cannot be substantially increased because of the need to build up reserves or to meet commercial indebtedness and other foreign obligations, a more vigorous control over the level of effective domestic demand would be particularly appropriate. Even where substantially greater imports of goods and services might well be permitted, control over the level of effective demand would be desirable if maximum benefits are to be realized.

Table V

Money Supply in Relation to Increase in Coffee Receipts
(millions of dollars)

	Total money supply, end of 1949 (except where otherwise noted)	Increases in coffee receipts, 1950 compared with 1949	Ratio of increase in coffee receipts to money supply %
Brazil	2880 (Nov.)	281	10
Colombia	466	119	25.5
El Salvador	40.3	6	14.9
Guatemala	57	7	12.3
Venezuela	458	14	3.1
Mexico	460 (Oct.)	5	8.7
Haiti	n.a.	5	--
Costa Rica	44.5	5	11.2
Nicaragua	22.4	11	49.1
Dominican Republic	46	2.5	5.4
Ecuador	52.5	1.6	3.0

The prevalence in many countries of inflationary pressures emanating from sources other than larger coffee receipts renders government control of the impact of increased coffee receipts particularly difficult. In those countries where development projects are well advanced and their execution is being accelerated, it would seem highly desirable if some restrictive measures could be enacted so that the full amount of the price increase would not accrue to producers and exporters. In view of the long-term coffee outlook, some encouragement to coffee production appears desirable, but to permit private producers full disposition of the increased income accruing to the economy from the coffee bonanza may not be consistent with long-term development objectives. It is clear that there are many development projects of a public nature needed--including health, education, and public works--which probably could not be financed by private investment. It will be possible to fulfill these programs in an environment relatively free from inflation only if the command over resources by private income recipients is limited, and if other governmental demands are carefully controlled as well.

The larger coffee receipts which are expected during 1950 thus appear to hold significant economic implications for the principal coffee exporting countries of Latin America. It is clear that the intelligent pursuit of economic policy objectives necessarily involves fundamental decisions regarding investment and consumption levels, the distribution of income, selection among investment alternatives, availability of domestic and foreign resources and the extent and kind of governmental influence required. If resources are to be effectively utilized for developmental purposes, their proper allocation will probably require some exercise of governmental powers over the random operations of individuals. With coffee profits even now beginning to be realized, it would seem desirable to consider at once the immediate and urgent problem of controlling the impact of such profits.

There are various avenues of approach to this problem. In countries where delivery of foreign exchange to the authorities is required, it is possible that some of the increase in coffee receipts could be absorbed by a program of forced savings. Under this program exporters would receive only a part of their exchange proceeds in the form of money and the remainder in some type of blocked asset such as long-term non-negotiable bonds, redeemable before maturity if economic conditions justify redemption. The vigorous exercise of central bank powers to increase reserve ratios and to limit rediscount operations would certainly contribute to a control over aggregate demand but it should be recognized that primary reliance upon such techniques would reserve to private banks the authority to decide, in accordance with conventional profit and risk considerations, what investments to finance. Selective credit control measures, although difficult to administer, might be considered by these countries. Exploration of the potentialities of qualitative credit controls would be particularly desirable since employment of appropriate direct controls is subject to special limitations in most of these countries. Some direct controls, such as the allocation of building materials, which is of considerable importance to many of the countries under consideration might be attempted. For example, this would provide a means for discouraging the construction of luxury housing and thus release resources for investment in projects more closely related to the public interest.

In their deliberations over what measures to adopt in the present circumstances, the various governments concerned would be well advised to consider the imposition of heavier taxes. The incidence of such a tax program should provide for a fair distribution of essential consumers' goods at whatever level of consumption is deemed appropriate. Insofar as possible, it should also prevent the dissipation of large incomes in ventures of but little importance to the national interest. Such a tax program might include more substantial income taxes of general application. Coffee growers, however, could still be left with a substantial part of their higher profits unimpaired and available for the expansion of coffee production or for other purposes. In cases where governments fear an over-expansion of coffee production, a heavy tax on coffee exports would be particularly appropriate since it would reduce the present strong incentive to expand plantings. On the other hand, where governments would prefer to rely to a greater extent on private decisions with respect to investment in the coffee industry or alternative types of investment, greater reliance on general income taxes would be in order.[1] From an administrative point of view, larger export taxes might be much easier to collect than income taxes in some countries and might present fewer problems of evasion.

Since the increase in coffee prices last fall, no general increases in income taxes have been reported for the Latin American coffee producing countries and only five, Costa Rica, Guatemala, El Salvador, the Dominican Republic and Venezuela, have attempted to impose heavier coffee taxes. The Costa Rican measure, which became effective March 7, provides for a tax of 2-1/4 per cent to be levied on the value of coffee delivered to processors. More than half of this tax is to be devoted to the improvement and development of the Costa Rican coffee industry. The Guatemalan tax, which was recently reported to have been vetoed by the President, provided for an ad valorem export tax of 15 per cent in lieu of the existing specific export tax of $1.50 per quintal. The new tax represented nearly a five-fold increase at current coffee prices. The Salvadoran measure raises the tax on coffee exports from 7 colones to 10.40 colones per quintal. The tax on coffee exports of the Dominican Republic increases the rate from 21.55 per cent of the f.o.b. value to 23 per cent. The Venezuelan measure imposed an export tax of 5 cents per pound on unwashed, and 6 cents per pound on washed coffee. All of these taxes are of nominal dimensions, however, leaving intact most of the increase in coffee profits.

The failure to resort more generally to the use of taxes, despite a clearly demonstrated need to direct and control effective demand, is paralleled by inaction in other fields of governmental policy. The Latin American coffee producing republics are slowly becoming aware of the problems presented and opportunities offered by the favorable coffee outlook. However, there seems to be little evidence that governments are prepared to take steps called for by the present situation.

1/ General income taxes are imposed in the following coffee producing countries: Brazil, Colombia, Costa Rica, Ecuador, El Salvador, Mexico and Venezuela.