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DEPRESSION IN IRAN

Mary Maroney

The deterioration of economic conditions in Iran has been causing increasing concern in recent months. The United States is planning to aid in improving the situation with a program that may include loans as well as the help of American experts. An economic mission has recently departed for Teheran to study the situation. The International Bank for Reconstruction and Development also is completing an analysis of projects programmed under the Iranian Seven Year Development Plan which might be suitable for loans from that institution. Special factors are responsible for the depth of the depression but in the main it is a local phase of the general problem of readjustment from war to peacetime condition

Except for the large petroleum production of the British owned Anglo-Iranian Oil Company, Iran is primarily agricultural and underdeveloped industrially. Two-thirds of the area is in deserts and mountain ranges but the country is nearly self-sufficient in food although dependent on imports for the great bulk of other requirements. Normally, income from oil more than covers the trade deficit. Wealth and land are concentrated in relatively few hands. The financial structure is dominated by the government owned Bank Melli (i. e. National Bank) which is a commercial bank as well as the bank of issue.

Causes of the depression

The petroleum production, plus the fact that the country could serve as an overland supply route for Russia via the Persian Gulf, made the area strategically important during the war years. Numbers of military personnel were stationed there and their expenditures coupled with the inevitable deficiencies of supply, brought about a severe inflation of prices, the severest experienced anywhere in the Middle East.

The end of the war did not bring an immediate reversal of conditions. Althou some of the local pressures eased, the world wide scarcity of goods was maintaine and prices continued to advance. The wholesale price index, which was 533 per cent of the 1936-37 base at the middle of 1946, rose to a post-war peak of 759 in November 1948. The cost of living, which was 726 in July 1946, rose to 1023 per cent in April 1949. Under these conditions the Bank Melli undertook an appreciation of the currency in order to bring down the "unbearably" high cost of living. Having fairly large supplies of foreign exchange and control of the forei exchange market, the Bank put exchange at the disposal of importers via the alread established certificate system, which brought the effective rate on dollars down from a high of 60 rials at the end of 1948 to 40 rials by September, 1949. Since then it has been held at this level. The official rate, which is used principally to cover government requirements and for the purchase of rials by the petroleum company to cover local expenditures, was continued at 32.50 rials.

The encouragement of imports was reflected in a rapid reversal of the price trend in 1949 and 1950. The cost of living index declined 121 points by December 1949 and another 88 points by April 1950. Wholesale prices declined about 30 per cent from November 1948 to April 1950. The pace of the deflation was stepped up by a crop failure during the summer of 1949 which reduced purchasing power and by the devaluation of sterling in September, which made exports more difficult. Commenting on the price decline, the Bank Melli says that wholesale prices in Iran had fallen for the most part to world levels. The official record of the value of imports, excluding imports for the oil company, shows that in the eleven months ended November, 1949, they about doubled as compared with the same period of 1948. Since the rial value of the goods was declining, this must have meant a very large increase in physical volume. Extraordinary imports of wheat, which were due to the crop failure, formed an important part of the increase but there were other gains, including textiles particularly, which compete with the new local production.

Contraction of credit and note circulation

The course of the deflation has been marked by a significant decline in the note circulation. Of the total note issue of 7.8 billion rials, 6.3 billion were in circulation on March 20, 1950, as compared with 6.6 billions on the corresponding date of last year. Deposits (non government) on these dates were 9.5 billion rials and 8.8 billion rials, respectively. Loans and advances to private accounts amounted to 1.3 billion rials, as compared with 1.1 billion on that date last year. There is a wide difference of opinion between the Bank and the business community as to whether these figures represent a satisfactory expansion of the credit base in the light of the declining activity. The Bank makes much of the fact that in the past year its interest rate has been reduced from 5 to 4 per cent. It is said, however, that this rate is not important because the loans are few. The loan ratio is ordinarily low because the Bank, by statutory limitation, may make loans only on two-name collateral, which condition is probably very difficult to satisfy in circumstances characterized by general and spreading trade decline. The rates charged by the bazaar money lenders, who are doing the loan business, are said to range from 30 to 40 per cent.

In explanation of its general policy, the Bank has made no secret of its attitude toward the inefficient elements of the industrial population. In its 1948 annual report which was published in March 1949, it was noted that "although foreign commodities are subject to extra cost of freight, insurance and customs duties (amounting to 40 or 50 per cent of their total cost), they are sold in the home markets /Iran/ at cheaper prices than similar home made goods". Later, in the June-September report, it continued to take local manufactureres to task for their failure, in spite of low paid manpower and local raw material advantages, in failing to face up to American competition on the domestic market. Instead of improving the quality of their products, they resorted to every device to check the normal downfall in prices. They hoped to have the frontiers closed to foreign goods and the consumer foot the bill for their inefficiency and mismanagement.

Although the Bank in this same bulletin said categorically that allegations that credits had been reduced or withheld did not correspond to the facts, it is possible to trace in the policy declaration the bases for the local feeling that the Bank's loan policy is not liberal. In an indirect way, also, the Bank has curtailed the amount of commercial credit that might have been extended in the crisis through its cavalier treatment of its only real competitor in the commercial banking field, the British Bank of Iran and the Middle East. Legislation was passed a year ago, reportedly on the Bank Melli's influence, requiring all foreign banks to carry a very high proportion of their deposits interest free with the Bank Melli. The proportion is 55 per cent of their deposits up to 225 per cent of their capital and reserves and 100 per cent for any excess of that amount. 1/ This punitive legislation was intended to give the Bank Melli a virtual monopoly of the commercial banking business and the objective has been obtained.

Role of government budget; the seven year development plan

Another explanation of the Bank's caution in lending is that it has been conserving its reserves against government needs which could be met in no other way. There is no private lending to the government and the central bank's advances have, therefore, a critical relation to the budget, a fact that is acknowledged by the law passed after the war which prohibited increases in the note issue without the consent of the Majless (Parliament). Even in recent years when the revenue position has been relatively easy and the Majless has been holding out the stricture that the budget outgo must remain within income, the Bank seems to have been increasing its advances to the administration. They rose from 2.5 to 4.0 billion rials in the fiscal years 1944-1949; the increase, however, was almost exactly balanced by a rise in government deposits from 1.2 to 2.7 billions. In this last year ended March 20, 1950, there was a further rise in advances to 4.6 billion rials but government deposits declined from 2.7 to 2.5 billion rials.

Substance is lent the conjecture that the Bank has been concerned over possible government calls on its reserves by the fact that the government has in this last year embarked actively on the long talked of Seven Year Development Plan. This ambitious program, the name of which suggests the popular appeal in that part of the world of Soviet Russia's long term planning, is expected to cost in the neighborhood of $650 million (21 billion rials), and is expected to be provided by international loans as well as local contributions. The Iranian share is to be the government's revenue from the petroleum production which will be set aside for the Plan's support and supplemented when necessary by loans from the Bank Melli. The diversion of funds began in the fiscal year ended March 20, 1949, but only a minor portion of the oil royalties was turned over. In the last year, however, the diversion extended to all the royalties and profits received amounting to approximately 1.4 billion rials.

The budget for 1949-50 appears to have registered a deficit that comes close to the amount diverted from the petroleum royalties. There is a considerable confusion in the published statements of revenue and expenditures because the imports of wheat and sugar, necessitated by the drought, were paid for by the government pending sales. However, revenues seem to have been about 8.2 billion rials and the expenditures were about 9.6 billion. (These figures have been estimated from partial returns for the year and on the basis of the Bank Melli's advances). The tax reform which was expected to improve the yield of direct

1/ In addition, foreign exchange to the amount of capital and reserves employed in Iran are required to be turned over to the Bank Melli in exchange for rials although withdrawal is provided for on termination of banking operations on six months notice.

taxes, has not worked out so well, apparently because of the larger exemptions for the upper middle class. The only improvement in the revenue position comes from the increased customs collections which in turn can be traced back to the increased imports which helped to set the depression in motion. For the current year, the yield from both these directions may be expected to decline.

Depletion of foreign exchange reserves; oil royalties

There have been also some repercussions in the balance of payments from the increased imports. A relatively easy situation in gold and foreign exchange assets existed up to April 1949 when about $95 million was available and not obligated as note cover. 1/ However, because of the special imports due to the drought, and the fact that sterling devaluation contracted the markets for the country's few export specialties, these assets were run down during the remainder of 1949 and the early part of 1950 and now amount to about $55 million. Implementation of the Seven Year Plan in regard to capital goods imports is particularly prejudiced by this development.

There is, however, an unreal quality to the stringency because the income potentialties from the oil production remain unrealized. More than a year ago the terms of the oil concession (which dates back to 1933) were renegotiated by the Anglo Iranian Oil Company with the Government. The new contract increases the basic royalty from an effective rate of 5s. 9d. to 8s. 7½d. per metric ton. There was also a material revision of that portion of the concession which related to the distribution of profits from operations. Under the old agreement, the Iranian government received 20 per cent of any profits distribution amounting to more than £ 671,250 on the ordinary stock (a sum equal to 5 per cent of the ordinary stock at the time of the 1933 concession), and since the British government has been limiting dividends, the Iranian government did not receive any benefit from the large amounts added to the Company's reserves in recent years. The amended provision, however, gave Iran 20 per cent of the amount of the current reserve funds of the Company before taxes by the British government, as well as 20 per cent of all subsequent additions to the reserve. (A minimum payment of £4 million annually is guaranteed on this latter account). The renegotiated contract was submitted to the 1949 Majless but was not approved before adjournment. From both reserves and royalty payments the government might have realized on the 1949 production of 30.5 million metric tons a total of about £ 23 million, instead of the £ 13.6 million actually turned over; in addition, a non-recurring payment on reserves and royalty arrears of £ 14.5 million have been due. The country is thus getting along without some £ 24 million ($67 million) which it would have received if the amended contract had been ratified.

There is little question that the petroleum contract will eventually be amended since the current return is low in relation to that received by other governments in the surrounding Persian Gulf area. The real point at issue is by how much the revenue from this source can be increased without forcing cutbacks in production, as the result of the competition of producers whose costs have followed sterling down.

1/ There is a 100 per cent cover requirement divided between 60 per cent gold and 40 per cent foreign exchange.

In addition to contributing directly to the government's income, the oil company also makes large local expenditures for wages and minor supplies. These funds come into Iran in sterling and are converted by the Bank Melli into rials at the official rate of exchange. The amounts of sterling so derived are larger than those obtained by royalty under the present agreement. In all sterling receipts on the 1949 volume of oil production were about £ 32 million ($90 million) and if the renegotiated contract were accepted, they would be, on current account, at least £ 41.5 million, or about $116 million.

Conclusion

It is obvious that there will be pressure on the government of Iran to make some decisions - (1) to improve the technical position of the central bank by reducing the cover requirement and removing the ceiling from the note issue and (2) to make some arrangements, whether loan or contract, to realize on the revenue which has been already offered by petroleum concessionaires. As an indication of the better possibility, the Anglo-Iranian Oil Company was recently reported to have loaned the government £6 million interest free, the payment to be deducted from future oil royalties. It is to be noted, however, that both of these courses of action have been proposed before and proved to be politically difficult. The tendency is to think of the petroleum revenue unrealistically as capable of indefinite expansion. As to the currency, there is deep popular distrust of any dilution of the hard money value. Like the rest of the Middle East, the country retains a distinct preference for metals which a troubled financial experience has done nothing to break down.

As the result of this current deflation, there is also to be seen on the horizon a long-term problem facing the country with respect to the amount of assistance local industries should receive in relation to the Seven Year Plan. Subsidies in one form or other, chiefly by way of the provision of government capital, have been the rule. A decision was taken in the past year to turn over to the Seven Year Plan organization the Industrial and Mining Bank, which has been the vehicle for dispensing capital. The production units the Bank brought along to the Plan were already operating at a loss and the Plan has accordingly been handicapped by having to spend funds for their immediate support pending their winding up or transfer to other projects deemed more economical.

Finally, one of the country's major difficulties, from the viewpoint of attracting local private investment, will be in overcoming the national urge toward spectacular and large scale developments, generally of an industrial nature. Small-scale development of primary industries, and particulary agriculture which employs the mass of the population, would have a wider influence on the general standard of living. The landed class, in whose hands the country's wealth is concentrated, does not want to invest in such small improvements, especially if they cannot control the newly established enterprises. Foreign investment likewise is confronted with the problem of un-cooperative local machinery. For these reason, the progress of economic expansion is likely to be exasperatingly slow.

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AUSTRIAN ECONOMY - AN EVALUATION Gordon B. Grimwood

The economic recovery of Austria in the post-war years has proceeded at a remarkable rate, considering the structural distortions in the economy left by the German "anschluss" of 1938 and the succeeding years of war. Most importantly, inflationary pressures have been contained since the monetary reform of 1948 and social unrest has been avoided by close cooperation between the Austrian government and the trade unions. The standard of living, while still low, has increased markedly in the past two years and is still rising.

Many of Austria's major economic problems stem from political difficulties which are beyond the power of action by the Government. The failure of the Allied Powers to agree on a peace treaty leaves Austria occupied by troops of four nations; occupation costs form an important part of Austria's public budget and have made necessary a special tax to cover such expense. The Russian occupation of Austria's eastern zone has meant a continuous drain of Austrian goods and foreign exchange through the "hole in the East", and especially the loss of irreplaceable mineral reserves which are being exploited by the Russians for their own benefit.

Despite these and other serious problems, Austria has made great strides towards achieving a balance in her internal economy. Production, particularly in the heavy industries, has increased to a level well above pre-war; 1/ most consumers' goods industries stand at or near the pre-war level. Productivity, although still 15 to 20 per cent below pre-war, is rising steadily. The total number of employed persons in Austria is higher by one-third than before the war, as women and other members of the family have found it necessary to seek work. Unemployment became a serious problem during the latter part of 1949 and the early part of 1950, 2/ but it has been reduced through the conscious efforts on the part of the Government to expand the construction industry and to arrange for the eventual absorption of construction workers into other industries.

The Austrian government has been able to achieve a balance in the ordinary budget during 1949. Faced with an estimated deficit for the year of 2 or 3 billion schillings, the Government revised the ordinary budget in May 1949 and for the year managed to achieve a surplus of 95 million schillings. Budget results for the first quarter of 1950 were even more favorable; a surplus in the ordinary budget of 192 million schillings will contribute substantially to the extraordinary or investment budget which otherwise will have to be financed mainly by counterpart funds.

Money and credit 3/

The supply of money and credit has shown remarkable stability. Aided by a cautious counterpart release policy by the ECA, the Austrian government was able to keep the note circulation and free central bank deposits virtually unchanged during 1949. Demand deposits of commercial banks

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1/ See Table I, Appendix
2/ See Table II, Appendix
3/ See Tables III and IV, Appendix

increased by 25 per cent during the year, and by December were higher than total note circulation for the first time since before the war. This development reflects an increasing confidence in the stability of the currency and a decline in the number as well as the magnitude of black market operations. The increase in demand deposits came to a virtual stop in the first quarter of 1950, but time and savings deposits continued their upward movement, showing a further increase of 17 per cent during the first quarter of 1950 after a rise of 36 per cent during 1949. These deposits are important since they will provide a ready source of medium - and long-term credits once a normal capital market has again been established.

Domestic bank credit outstanding (excluding cooperatives) expanded by approximately 75 per cent during 1949 in order to provide industry with working balances and in many cases even fixed capital. Many short-term loans made during the year have virtually become medium-or long-term loans by constant renewal. This situation has caused commercial banks some embarrassment as their liquidity position declined during the year: primary reserves of commercial banks declined from 14.9 per cent of total deposits as of December 1948 to 11.4 per cent as of December 1949, and fell even further to 6.9 per cent as of March 31, 1950. Credit expansion continued during the first quarter of 1950, but the rate of increase declined from approximately 15 per cent per quarter in 1949 to about 5 per cent between December 31, 1949, and March 31, 1950. Bills rediscounted with the Austrian National Bank became important during the second quarter of 1949 as the bank's liquidity position deteriorated, but the amount of such bills had dropped sharply in 1950 as a result of the restrictive policy of the National Bank. 1/

Credit expansion through commercial bank lending was the only expansionary force in the field of money and credit during 1949 and also in the first quarter of 1950. The decline in the liquidity of the commercial banks has, however, enabled the Austrian National Bank to use its rediscount policies to control the magnitude of commercial bank credit. In addition there is pending in the Austrian Parliament a bill to permit the National Bank to control credit by means of minimum reserve requirements. The commercial banks hold large amounts of German assets which cannot be liquidated and which cannot be converted into new credits, although they have not yet been written off the books. The banks are currently engaged in an attempt to turn these assets over to the Government in return for discountable Government bonds. As long as such an exchange has not been made and as long as the Austrian National Bank adheres to its present conservative rediscounting policy, there seems little likelihood of inflationary pressure resulting from further credit expansion during the remainder of the year .

Prices, wages, and subsidies 2/

Two major events determined price developments in 1949. The first was the Third Wage-Price Agreement of May 1949, which resulted in the Government withdrawing a number of cost-of-living subsidies in an effort to

1/ See Table IV, Appendix
2/ See Tables V and VI, Appendix

balance the ordinary budget and letting prices rise, and at the same time, allowing a 10 per cent increase in wages. The second was the general European devaluation of September, and the devaluation of the Austrian schilling in November 1949.

As a result of the Third Wage-Price Agreement, wholesale prices increased by 25 per cent during the second quarter of 1949, while the cost-of-living index increased by 19 per cent. This did not, however, represent a fall in real wages or in the standard of living: the rise in the official index was largely offset by a drop in black market prices and by the payment of a childrens' food bonus. Both wholesale prices and the cost of living declined during the third quarter of 1949, but rose again in the fourth quarter as a result of the schilling devaluation.

Price developments during the first quarter of 1950 have shown diverging trends. The price of basic materials continued the rise begun in the fourth quarter of 1949, while the cost of living declined during the first quarter of 1950. This paradoxical situation can be explained by Government intervention in the operation of the market. Increasing prices during the fourth quarter of 1949 brought about new demands by the trade unions for wage increases or for higher cost-of-living subsidies. Unable to grant higher subsidies and still maintain a balanced budget and afraid of a wage-price spiral if wage increases were granted, the Austrian government engaged in a drive to lower prices of the more important cost-of-living items. This effort, undertaken in cooperation with labor and industry and made possible by open subsidies and a preferential exchange rate for the importation of ECA-financed necessities, apparently has been successful; the cost of living index for May 1950 has fallen below the level of May 1949 and is approximately at the level of September 1949. The decline has taken place entirely in foodstuffs, with other items remaining unchanged or rising slightly.

Pressure on the cost structures of manufacturing industries caused by higher domestic prices for imported raw materials will result im higher prices for manufactured articles unless industry is able to absorb the increase by a rise in productivity or through a reduction in profits. Profit margins now are extremely high and could, therefore, be used as a "buffer" as the cost-price structure of Austria becomes more closely allied with that of other countries producing for the world market.

The subsidies presently implicit in preferential exchange rates for certain commodities and their relation to the Austrian price structure will become important during 1950 as the Austrian government moves toward a unitary exchange rate. It has been argued that, since the cost of living rose only fractionally after the November devaluation and declined again soon thereafter, the devaluation which would be implicit in the adoption of a unitary rate would not result in a rise in the cost of living. This reasoning appears overoptimistic: the November devaluation had no effect on the most important items in the cost-of-living index because of the accompanying rise in open and implied subsidies. The introduction of a unitary rate and an outright abolition of these subsidies would certainly result in a sharper increase in the cost of living and might bring about demands for a fourth round of wage increases.

Neither a renewed inflationary spiral, nor a reduction in the level of consumption - which, despite substantial progress during the past year is still below prewar for the bulk of the working population - can be accepted as the goal of Austria's price-wage policy. Only a further increase in productivity will permit rising consumption and the necessary increase in the share of the national income devoted to investment.

The Austrian government recognizes that the establishment of a unitary exchange rate is absolutely necessary in order to rationalize the pattern of Austria's production and foreign trade. In addition, the subsidies on agricultural products are seriously discouraging domestic production of these products and are leading to unnecessary imports. The gradual removal of the subsidies seems inevitable, therefore, despite the impact of such action on the present balance between wages and prices.

Investment program

The Austrian investment program, just released, for the three-year period 1950-1952, contemplates gross investments of 28.7 billion schillings, an average of approximately 22 per cent of gross national product for each year. The total amount of net investment will be about 18 billion schillings, 35 per cent of which will be financed by counterpart releases, 24 per cent by other public funds, and 41 per cent by the private capital market. In evaluating the investment program from the standpoint of available resources, it is necessary to examine the development of these three major sources of investment funds.

Counterpart fund releases are programmed over the next three years at approximately 3 billion schillings for 1950, 2 billion schillings for 1951, and 1 billion schillings for 1952. From the known amounts of direct and conditional aid which will be available to Austria during the remainder of the ECA program, it can be roughly estimated what amounts will be deposited in the counterpart fund over the period. The only variable factors are possible changes in the amount of that aid and the so-called "price gap" financing presently required by the Austrian government's system of subsidies.

As has been mentioned, certain commodities, (primarily food products) are imported and sold on the domestic market at prices lower than the effective rate of 21.36 schillings per dollar. Since the Austrian government is required to make deposits in the counterpart fund at the 21.36 rate, the difference between their receipts from sales and the required counterpart deposit has been made up by advances to the Government from the Austrian National Bank under a law enacted for that purpose. In order to avoid the inflationary impact of this procedure, the schilling amount in the counterpart fund representing this price gap has not been considered available for release. It is obvious, therefore, that the amount of counterpart funds available over the next three years will depend upon the amount of the subsidies and the methods of financing them.

The ECA Special Mission to Austria has estimated counterpart availability for 1950 on the assumption that the subsidies would be withdrawn gradually over the next year. The Mission estimates that a net amount of 3.5 billion schillings will be available for release during 1950 - more than ample to meet the target figure. If subsidies can be withdrawn as planned, there is no reason to doubt that the requisite sums will be available during 1951 and 1952.

Concerning the availability of funds from other sources in the program, there is less reason for optimism. Due largely to political uncertainties, there has been no reestablishment of a normal capital market since the end of the war. Private investment in stocks and bonds during 1949 amounted to only 1.1 billion schillings. The Austrian government expects to raise the major portion of the 7,355 million schillings programmed for private investment by requiring firms receiving counterpart funds to engage in a certain amount of self-financing. Since no realistic estimate can be made as to the amount of self-financing which took place last year, it is difficult to say whether or not this target can be met. However, the rapid growth of savings deposits over 1949, which has continued into 1950, will permit banks to engage in medium-and long-term financing to a greater extent than has so far been possible.

Public funds, other than counterpart, are expected to provide 4,307 million schillings over the next three years. At the present time, it is difficult to see how these funds will be raised. Since the Austrian National Bank is forbidden by law to advance funds to the Government (with the exception of funds advanced for "price gap" financing), the only available place to borrow is the private capital market. Results of a reconstruction loan floated by the Government during 1949 were discouraging; the total amount received in cash amounted to only 134 million schillings. A surplus in the ordinary budget for first quarter 1950 makes it possible to reduce somewhat the deficit in the extraordinary budget, but it is doubtful if such a surplus can be counted upon as a permanent source of investment funds.

In making decisions regarding the direction of available investment funds, the Austrian government is faced by the fact that Austria's pre-war production pattern was drastically changed by German investment in heavy industries after the "anschluss" of 1938. Before the war, the major portion of Austria's production was in small finished-products industries, whereas now primary iron and steel products and mining occupy important positions in the production index.

These industries, whether or not they represent an economic allocation of resources, are in existence and this fact must be considered in the over-all allocation of available investment funds.

Acting on the assumption that the investment program should be directed in such a way as to eliminate the deficit in the balance of payments as rapidly as possible, the ECA Special Mission to Austria severely criticized the original program because it could not achieve that objective. By reducing the proportion to be spent on the Federal Railroad and public construction and increasing expenditures on agriculture, tourism, and finished-products industries the revised program just released by the Austrian government has met some of this criticism. In reply to other criticism that 7 per cent of the total investment for three years is too high for primary iron and steel and metal industries, the Government points out that these projects must be finished in order to avoid losing the funds already invested. The Government also contends that repair and modernization in the primary industries will enable those industries to furnish raw materials to the end industries at lower costs, thus putting the latter in a better competitive position. This last argument is tenable only if it is conceded that the primary industries can produce these raw materials at costs lower than the cost of imported raw materials; so far, they have been able to do so only with the aid of indirect import and export subsidies embodied in exchange rate differentials.

Public construction still occupies an important place in total investment on the theory that these labor-consuming industries will prove of assistance in solving the unemployment problem. The sharp drop in the number of unemployed since good weather permitted these industries to resume operations demonstrates the success of such a program from this point of view. Investment in public construction can do little, however, to aid in reducing the deficit in the balance of payments and it might even increase it by increasing the demand for imports through higher incomes.

The availability of programmed investment funds will depend upon the establishment of a normal capital market and the maintenance of a high level of economic activity. The Austrian National Bank must use monetary controls wisely, since either a deflation or a continuation of inflation would cause Government revenues to drop, would endanger monetary stability, and would drastically reduce the amount of self-financing which is expected over the next few years. It would seem that continued investment in heavy industry can serve only to perpetuate the distortion of economic resources begun by the Germans. Austria is not competitive in these markets, and many of them are already becoming glutted. The ability of these primary industries to dispose of their products on the domestic market will depend entirely upon the success of end-product industries in expanding exports over the nest two years. It may be more desirable to expand production in the export industries and to absorb labor presently employed in public construction in these more productive fields.

Balance of payments

Austria has been unsuccessful in the attempt to achieve an external balance since the war. At the end of 1949 her foreign trade still remained approximately 25 per cent below 1937 by volume, and exports covered about 50 percent of imports as compared with 85 per cent before the war. Statistics for the first quarter of 1950 indicate that the devaluation of the schilling did not bring about the hoped-for expansion of exports, since they still covered only 51 per cent of imports for the period.

Changes in the direction and composition of trade are shown in the attached Tables VII and VIII. In examining the commodity breakdown, it should also be remembered that many transactions for raw materials and finished products took place during 1949 under compensation and barter deals which involved different implicit exchange rates; consequently, value figures in schillings for these categories may be somewhat exaggerated. In addition, the "hole in the East" still exists. Exports made by Russian-operated industries in the Soviet zone of occupation are not reported, and smuggling tolerated by the Soviet authorities constitutes an even more serious drain on Austrian resources.

The fact that exports have not expanded since November 1949 indicates that the de jure devaluation of the schilling, which in effect recognized a de facto situation, has not succeeded in relating Austria's cost structure to world markets in such a way as to make Austrian exports competitive. In addition to this, a continued high demand for goods on the domestic market has enabled Austrian traders to realize high profits on that market; therefore, there has been no initiative to search for export markets. A recent report indicates that the present tight money situation has dampened domestic demand and has resulted in more of an effort to seek export outlets on the part of businessmen.

The Austrian exchange system rate, as revised in January 1950, still retains a procedure under which the Austrian exporter may keep a portion of his foreign exchange. In practice this procedure results in varying implicit rates for various transactions. The fact that such "extra-legal" exchange is available, at a price, encourages imports of luxury items which bring high profits on the domestic market. With the cooperation of the International Monetary Fund and the ECA, the Austrian government is working toward the adoption during 1950 of a unitary rate of exchange. The black market rate for the schilling, usually a good indicator of the actual value of a currency, has for the first time dropped below 30 schillings to the dollar, and is now very close to the official "premium" rate of 26 schillings to the dollar. The ECA Mission has recommended that the Austrian government provide facilities which will make it easier for tourists to exchange their money legally, thus siphoning a larger amount of such exchange into the Austrian National Bank.

Based on the 1949 deficit, converted at a rate of 21.36 schillings per dollar, the Austrian government has estimated an annual deficit in the balance of payments of 6.6 billion schillings. On the basis of a detailed industry study, the Government estimates that the three-year investment program will result in an expansion of exports and curtailment of imports which, taken together, will represent an improvement in the balance of payments of 4.2 billion schillings annually between 1950 and 1952. The report also points out that other factors, such as a possible fall in world prices of food and raw materials, might permit a balance on foreign account by 1952.

It is difficult to evaluate such estimates. On the basis of past developments in the export markets, however, they would seem optimistic. It is generally agreed that the only feasible way in which a balance on foreign account can be reached is through an expansion of exports. To achieve this expansion, the Austrian cost structure must be made competitive through increased productivity, and this cost structure must be linked to the world economy by a realistic exchange rate. Domestic prices must be lowered in order to get away from high domestic profits which are inhibiting the export trade. From a general point of view, it seems probable that Austria will be able to improve her external position over the next three years; but it seems equally probable that a deficit in the current balance of payments will remain after the conclusion of the ECA program if a sudden deop in Austria's level of production and consumption is to be avoided.

STATISTICAL APPENDIX

Table I
Production Index
(1937 - 100)

	Total Index	Mining	Magne-Site	Iron Works	Metal Works	Foun-dry	Vehi-cles	Mach-inery	Wood Prod	Elec. Mfgs.	Chemi-cals	Paper and Mfgs.	Leather and Shoes	Textile	Food Prod.	Tobacco
1948 Monthly Average	89	102	120	107	162	96	84	100	108	103	121	67	56	51	76	85
1949																
March	106	115	150	147	79	114	148	151	107	130	124	85	81	76	79	52
June	122	114	163	137	328	106	133	150	167	131	169	86	95	76	110	75
Sept.	133	122	169	158	295	128	146	163	183	182	178	86	81	90	107	98
Dec.	130	124	147	149	93	137	161	180	139	203	173	87	71	91	100	114
1950																
March	142	133	169	166	113	155	153	189	138	203	193	97	104	107	105	135

Source: Monthly Report of the Austrian Institute for Economic Research

TABLE II
Labor Market

Date	Employed	Unemployed
1949		
March	1,862,173	130,178
June	1,951,647	80,645
Sept.	1,982,720	72,315
Dec.	1,899,666	139,584
1950		
March	1,885,137	157,226
April	1,916,533	127,697

Source: Monthly Report of Austrian National Bank

TABLE III
Financial Developments
(Millions of Schillings)

Date	Note Circulation	Free Giro Accounts	Sight Deposits	Total	Time Deposits
1948					
Dec.	5,635	1,377	4,799	11,811	1,227
1949					
March	5,833	963	4,930	11,726	1,461
June	5,797	927	5,330	12,054	1,562
Sept.	5,817	1,244	5,490	12,551	1,583
Dec.	5,721	1,675	5,987	13,383	1,670
1950					
March	5,611	1,290	6,067	12,968	1,954
April	5,618	1,270	N.A.	N.A.	N.A.

Source: Monthly Report of the Austrian National Bank

N. A. Not available

TABLE IV

Credit Extended by Austrian
Commercial Banks 1/
(Millions of Schillings)

Date	Short-term Loans	Mortgage Loans	Communal Loans	Bills Rediscount-ed with ANB	Total
Dec. 31,1948	2,501.0	495.9	270.6	- - - -	3,267.5
March 31,1949	2,783.8	522.9	337.5	- - - -	3,644.2
June 30,1949	2,992.1	561.6	363.1	464.6	4,381.4
Sept. 30,1949	3,301.0	593.0	404.8	671.9	4,970.7
Dec. 31,1949	3,749.9	614.2	446.4	892.2	5,702.7
March 31,1950	4,340.2	630.5	477.9	558.3	6,006.9

1/ Excluding credit cooperatives

Source: Supplement to monthly reports, Austrian National Bank

TABLE V

Prices, and Cost of Living
(1938 = 100)

Date	Basic Material Price	Cost of Living Foodstuff	Cost of Living Other	Total
1948-Monthly Av.	313	325	316	321
1949				
March	363	410	305	364
June	455	506	334	432
Sept.	432	472	346	417
Dec.	490	529	357	455
1950				
March	521	478	369	431
April	513	466	369	424
May	513	456	369	419

Source: Monthly Report of Austrian Institute for Economic Research

TABLE VI

Cost of Living and Take-Home Pay
(April 1945 = 100)

Date	Cost of Living: Total	Food	Rent	Light & Gas	Clothing	Household Furn	Take-Home Pay
1948-Monthly Av.	378	383	157	423	491	588	323
1949							
March	429	483	159	441	458	548	376
June	509	597	163	531	478	548	384
Sept.	491	557	163	527	497	565	418
Dec.	535	623	163	587	506	596	418
1950							
March	507	564	163	587	539	623	423
April	499	549	163	587	539	623	423
May	493	545	163	587	539	623	423

Source: Monthly Report of Austrian Institute for Economic Research

TABLE VII

Austria's Foreign Trade by Major Commodity Group
(Millions of Schillings)

Commodity Group	1937 1/	%	1949 Jan-June	%	1949 3rd. Qtr.	%	1949 4th Qtr.	%	1949 Total	%	1950 1st Qtr.	%
IMPORTS												
Foodstuffs	404.4	28	1,118.6 2/	37	399.1	27	583.6	32	2,101.5	33	771.0	31
Raw materials & semi-mfg.	620.4	43	1,259.5 2/	41	634.3	43	731.1	40	2,624.9	41	1,003.6	41
Finished Product	428.4	29	674.4 2/	22	431.4	30	499.9	28	1,605.7	25	662.2	28
Totals	1,453.2	100	3,052.5	100	1,464.8	100	1,814.6	100	6,331.9	100	2,456.8	100
EXPORTS												
Foodstuffs	51.6	4	12.1	1	4.1	1	16.5	2	32.7	1	27.2	2
Raw materials & semi-mfg.	363.6	30	674.8	43	258.7	35	341.8	37	1,275.3	39	496.3	40
Finished Product	801.6	66	896.8	56	467.4	64	556.3	61	1,920.5	60	720.9	58
Totals	1,216.8	100	1,583.7	100	730.2	100	914.6	100	3,228.5	100	1,244.4	100

1/ 1937 prices
2/ Estimated on basis of ECA breakdown of reported shipments for period. Totals do not agree exactly with those in Table VIII for that reason.

Sources: Monthly Reports of Austrian Institute for Economic Research
STATISTICHE NACHRICHTEN - July 1949 - May 1950

TABLE VIII

Austria's Foreign Trade by
Geographic Area
(Millions of Schillings)

Area	1937 1/	o/o	Jan-June	o/o	3rd Quarter	o/o	4th Quarter	o/o	1949 Total	o/o	1st Quarter	o/o
IMPORTS 2/												
West Europe	496.8	34	1,256.0	41	622.0	42	724.7	40	2,611.7	41	1,048.6	43
East Europe	475.2	33	449.1	15	194.8	13	249.7	14	893.6	14	333.3	13
U. S.	87.6	6	826.4	27	358.4	25	489.5	27	1,674.3	26	735.0	30
Other World	393.6	27	521.6	17	289.6	20	350.7	19	1,161.9	19	339.9	14
Total	1,453.2	100	3,062.1	100	1,464.8	100	1,814.6	100	6,341.5	100	2,456.8	100
EXPORTS 2/												
West Europe	554.4	46	1,116.5	71	356.8	49	472.0	52	1,945.3	60	597.3	48
East Europe	318.0	26	245.9	15	118.1	16	194.3	21	558.3	17	200.2	16
U. S.	31.2	2	42.0	3	26.4	4	27.7	3	96.1	3	61.2	5
Other World	313.2	26	179.2	11	228.9	31	220.6	24	628.7	20	385.7	31
Total	1,216.8	100	1,583.6	100	730.2	100	914.6	100	3,228.4	100	1,244.4	100

1/ 1937 prices
2/ Includes Yugoslavia

Source: Same as Table VII