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Internal Financial Policies and Economic Progress in OEEC Countries

Elinor Harris

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Internal Financial Policies and Economic Progress in OEEC Countries

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The Organization for European Economic Cooperation (OEEC) has reviewed the fourth annual reports on economic progress of its member countries. Annually, each member outlines its production, investment, and financial achievements since 1948. In addition, each member has projected its domestic and external national accounts through 1953-54 or 1954-55 and has indicated production and investment targets of its main industries. Most members also discussed their fiscal and monetary policies, and the relation of these policies to the problems of their balances of international payments.

On the whole, the country submissions have been disappointing to OEEC because, among other reasons, they seem to point up an apparently insolvable dilemma. Each member nation has been committed to achieve by 1956 the 25 per cent increase in its national product set in 1951 as a target for the countries receiving U. S. aid. However, attainment of this goal has often seemed to conflict with attempts to achieve better external balance and to combat domestic inflationary pressures.

No nation has devised a workable formula for meeting the financial and physical OEEC objectives simultaneously. Those countries which appear most pessimistic about the possibilities for future expansion of domestic production have, at the same time, most successfully achieved internal and in some cases external stability; application of monetary restraints in 1951 and 1952 has been an important factor in these stabilization programs. Similarly, those countries which have not yet brought post-Korean inflationary pressures completely under control through appropriate indirect (or direct) measures are most optimistic about attainment of the five-year production targets.

The submissions of Belgium, the Netherlands, Italy, France, Denmark, Sweden, and Norway illustrate most clearly the nature of the conflict. The German submission is not considered in this paper because, while pessimistic in tone, it deals chiefly with the attainment of defense aims.

The problem of external stability

All OEEC countries have experienced balance of payments deficits with the United States and Canada through 1952 (see Appendix Table I); with the exception of Denmark, they expect a continuation of these deficits through 1953-54. In contrast to the over-all balance, the balance with the dollar area does not seem to have been decisively affected by the recent strengthening in internal financial policies. All submissions, except that of Denmark, exhibit concern about the adequacy of their gold and dollar reserves, and agree that the dollar problem is basically "structural" (whatever this may mean). They contend that their dollar deficits cannot be eliminated except through further genuine international cooperation and, by implication, a reduction in United States tariff barriers and increased American lending. Attempts to increase sales to dollar countries by a redirection of investment and production and by improved production methods are generally not discussed in great detail.

There is also considerable pessimism about the future of multilateral trade and payments in general. The countries fear that rising military expenditures will increase their import requirements and at the same time discourage their exports by increasing domestic demand as well as production costs. There is concern about the possible effects of continued French and British trade deliberalization upon the exports of other member countries and upon the future of intra-European trade in general.

The relationship between general external and domestic stability

Although OEEC members generally are running chronic deficits with dollar countries, their intra-European and overall balances of payments show significant differences, and it is possible to distinguish clearly between the basic financial policies of (a) creditors and (b) debtors on intra-European account.

(a) Those OEEC nations which currently enjoy the greatest cumulative net surpluses with the European Payments Union (Belgium, the Netherlands, Italy, and Sweden) have reaffirmed in the OEEC submissions their belief in the dependence of external balance upon domestic financial stability. They state that stabilization of internal prices and costs through anti-inflationary monetary and budget policies should be given primary consideration. Italy and the Low Countries, adopting the most cautious approach, hesitate to expand military production or public investment beyond a level which they consider to be reasonably compatible with continued price stability. The Swedish Government, which places somewhat greater stress upon expansion in public works and public housing, emphasizes that monetary and fiscal measures must be combined to achieve both financial stability and full employment.

The external account of these countries clearly reflects this position. Italy has been a strong creditor on intra-European account until recently, when the new U. K. and French trade restrictions began to exert their full unfavorable effect upon Italian exports. Sweden not only has maintained a creditor position with EPU in most months but since 1949 has, in addition, obtained balance or near-balance on her external accounts for goods and services with all countries. As a rule, Belgium and the Netherlands continue to show credit balances against the European Payments Union as well as a current balance of payments surplus with all countries of the world combined.

Denmark, a country with a small net EPU deficit, nevertheless presents an unusual example of how external balance can be improved directly by adoption of anti-inflationary monetary and fiscal measures. The Danish submission discusses the deterioration in 1949 and 1950 in the country's balance of payments and its success in overcoming this imbalance through "radical" budgetary measures and a more restrictive Central Bank policy. The achievement is shown by the marked favorable change in Denmark's total external position between 1950 and 1952 and, moreover, by the expectation of possible future balance not only with the world as a whole but (if American off-shore purchases are included) with the dollar area also.

(b) In contrast, those countries which have neglected to use adequately restrictive financial policies, such as France and Norway, have shown substantial deficits on intra-European account. Norway expects its over-all as well as its dollar position to deteriorate in the fiscal year 1952-53, after two years of improvement. It looks to increased private loans from other countries to fill in the balance of payments gap. France's sizeable total as well as dollar current account deficits are kept from growing even larger merely by sharp import restrictions against OEEC as well as dollar countries.

France expects a marked reduction in its over-all and intra-European deficit in 1953-54. However, such a reduction would appear to require fundamental readjustments in the French pattern of trade and in French export prices. The French submission has been criticized because it does not discuss the possibilities of the needed adjustments, and in particular the problems of internal price levels and of the exchange rate of the French franc.

Domestic financial developments

A certain degree of internal stability has been attained at least temporarily in most countries (see Appendix Table 2). Two of the largest intra-European creditors (Belgium and the Netherlands) have achieved the greatest success in stabilizing consumer price levels. Another EPU creditor, Italy, achieved marked success in stabilizing prices in the period 1948 through mid-1950, although some further instability develcped following the Korean war. France, whose external total and dollar position has deteriorated more seriously than that of the other members of OEEC, has, at the same time, experienced the sharpest postwar rise both in the money supply and the consumer price index.

Varying degrees of money market restraint were reflected in changes in the availability and cost of credit. Belgium, the Netherlands, and Denmark have kept their postwar monetary expansion within narrow limits through increased reserve requirements and other credit restraint measures, including changes in the central bank discount rate. In view of increased unemployment and a decline in consumers' goods production in the first half of 1952, monetary controls have recently been relaxed somewhat in Belgium and the Netherlands.

The cost of living in Sweden has continued to rise, but at a slower rate, since the "cheap" money policy was partially abandoned in 1951 and interest rates have been permitted to rise slightly. As compared with December 1951, there has actually been a decline in Sweden in the supply of money held by the public and in domestic loans and investments of the banking system.

Norway, while reaffirming its adherence to a policy of continued low interest rates and its preference for fiscal over monetary controls, reports in its OEEC submission the introduction of bank reserve requirements. The Norwegian report also discusses the impact upon the banking system of budgetary policies which have involved surpluses and debt retirement. Continued rapid increases in consumer prices, accompanied by monetary expansion, indicate however the need for more comprehensive Central Bank action.

Since late 1951, the Bank of France has attempted to tighten credit through increased discount rates, more rigidly enforced secondary reserve requirements, and a more intensive "screening" of loan applications. The degree of internal instability in the French economy has doubtless been reduced somewhat by the actions of the Bank of France itself; with respect to fiscal policies, however, Premier Pinay has neither been able to balance the budget nor to induce the legislature to enact the administration's very modest proposals for tax reform.

Domestic production targets

The requirements of internal expansion and stability are frequently stated to be conflicting. France, Sweden, and Norway anticipate that the target for a 25 per cent expansion in national product between 1951 and 1955-56 may be met. Italy and the Low Countries, on the other hand, are pessimistic about attainment of the OEEC production goals (see Appendix Table 3). The country with the highest degree of external (and, until recently, internal) instability, France, anticipates the greatest proportionate increase (9.3 per cent) in gross national product between 1951 and 1953-54; the most stable country, Belgium, anticipates the smallest increase (4.0 per cent).

The Netherlands, Belgium, and Italy have been criticized for their failure to attain greater physical progress. They have replied that long-range progress has been impeded by moderate "recession" in the first eight months of 1952, particularly marked in consumers' goods industries; and, in the case of Belgium and Italy, by so-called "structural" unemployment. In addition, the Italian export markets and her economy have been affected adversely by French and British trade deliberalization in early 1952. The reappearance of an EPU deficit for Italy, until recently a strong EPU creditor, illustrates the rapidity with which balance of payments problems are currently transmitted from one nation to another. The country which attempts to maintain external balance through "orthodox" domestic financial practices, such as Italy, is hampered in its efforts to do so by the failure of other nations, such as France, to achieve trade balance except through trade restriction.

Conclusion

The country submissions indicate that the re-introduction of tight credit policies has generally been as effective in combatting post-Korean inflationary pressures in Western Europe as in the United States. A comparison between the American and foreign experience is particularly valid in the cases of the Netherlands and Denmark, but the trend toward increased use of monetary rather than direct controls also is apparent in varying degrees in most other OEEC countries. However, the reports do not discuss the effects of the new restrictive financial policies upon individual savings, private investment decisions, and the "climate" of business expectations generally. They are also lacking in analysis of "structural" internal financial problems, such as the inactivity of private capital markets, the low volume of private saving, the shortage and high cost of foreign capital, and the questions of tax reform and tax enforcement.

Finally, the alleged conflict between rapid physical expansion and financial stability has not been adequately investigated. The reports expect the rate of future expansion in production, investment, and incomes to be considerably lower than in the early years of the European Recovery Program. In view of this attitude, the long-range production targets set for OEEC countries need to be re-examined in order to determine whether their attainment would indeed be incompatible with maintenance of domestic and external balance.

APPENDIX

Table I

Net Current Balance of Payments of Metropolitan Areas

(In millions of U. S. dollars)

	1950	1951	1952e	1952-53p	1953-54p
Belgium-Luxembourg					
U. S. & Canada	-237	-292	-270	-190	-170
All countries	-279	+197	+ 72	+ 16	+ 12
Netherlands					
U. S. & Canada	-100	-207	-200	-181	-156
All countries	-282	- 34	+249	+ 26	+ 6
Italy					
U. S. & Canada	-217	-303	n.a.	-184	-162
All countries	- 84	-233	n.a.	-309	-259
France					
U. S. & Canada	-303	-395	n.a.	- 10	- 15
All countries	-115	-970	n.a.	-214	-114
Denmark					
U. S. & Canada	- 41	- 50	- 24	+ 4	+ 6
All countries	-100	- 13	+ 22	+ 33	+ 25
Sweden					
U. S. & Canada	- 18	- 48	n.a.	- 67	- 67
All countries	+ 34	+176	n.a.	- 72	+ 34
Norway					
U. S. & Canada	- 14	- 29	- 33	- 33	- 29
All countries	-121	+ 17	+ 70	- 84	- 84

n.a. - Not available
e - Estimated by member country
p - Projection of member country

Source: Fourth Annual OEEC Submissions of Member Countries

APPENDIX

Table 2

Financial and Monetary Developments

	Consumers' prices (1948=100; end of year)	Budget surplus (+) or deficit (-) (fiscal year)	Currency and demand deposits held by the public (Dec. 1949=100; end of year)	Discount rate (per cent per annum)	Domestic loans and investments of banks other than the Central Bank (end of year)	Government bond yield (per cent; average of months)
Belgium		(Billions of Belgian francs)			(Billions of Belgian francs)	
1948	100	n.a.	96	3 1/2	55	4.75
1949	97	- 15	100	3 1/4	57	4.60
1950	96	- 17	100	3 3/4	60	4.42
1951	105	- 23	108	3 1/4	68	4.62
2nd Quarter 1952	105	- 21 1/	110	3 1/4	71	4.51
Netherlands		(Millions of guilders)			(Millions of guilders)	
1948	100	n.a.	97	2 1/2	4,459	3.10
1949	106	-298	100	2 1/2	4,752	3.14
1950	116	+223	94	3	4,261	3.14
1951	128	+484	97	4	4,706	3.44
2nd Quarter 1952	127	+755 1/	101	3 1/2	5,066	3.41
Italy		(Billions of lire)			(Billions of lire)	
1948	100	-846	88	5 1/2	1,550	4.40
1949	101	-495	100	4 1/2	1,916	4.52
1950	100	-295	111	4	2,321	4.79
1951	110	-262	128	4	2,763	5.08
2nd Quarter 1952	115	-424 1/	130	4	2,921	5.25

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APPENDIX

Table 2 Continued

	Consumers' prices (1948=100; end of year)	Budget surplus (+) or deficit (-) (fiscal year)	Currency and demand deposits held by the public (Dec. 1949=100; end of year)	Discount rate (per cent per annum)	Domestic loans and investments of banks other than the Central Bank (end of year)	Government bond yield (per cent; average of months)
France		(Billions of francs)			(Billions of francs)	
1948	100	-783	80	3	908	4.62
1949	118	-675	100	3	1,146	4.78
1950	131	-607	115	2 1/2	1,211	6.52
1951	154	-503	136	4	1,406	6.54
2nd Quarter 1952	169	-700 1/	142	4	1,566	5.17
Denmark		(Millions of kroner)			(Millions of kroner)	
1948	100	n.a.	105	3 1/2	9,387	4.07
1949	101	+237	100	3 1/2	9,674	4.44
1950	107	+252	100	5	10,359	4.53
1951	119	+415	102	5	10,572	5.14
2nd Quarter 1952	124	+315 1/	103	5	10,900	5.32
Sweden		(Millions of kroner)			(Millions of kroner)	
1948	100	+ 93	97	2 1/2	8,550	3.08
1949	102	-159	100	2 1/2	9,230	3.02
1950	103	-426	106	3	10,170	3.11
1951	119	-197	127	3	11,840	3.23
2nd Quarter 1952	131	+ 77 1/	122	3	11,420	3.30

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APPENDIX

Table 2 Continued

	Consumers' prices (1948=100; end of year)	Budget surplus (+) or deficit (-) (fiscal year)	Currency and demand deposits held by the public (Dec. 1949=100; end of year)	Discount rate (per cent per annum)	Domestic loans and investments of banks other than the Central Bank (end of year)	Government bond yield (per cent; average of month)
Norway		(Millions of kroner)			(Millions of kroner)	
1948	100	+397	98	2 1/2	8,290	2.49
1949	100	+130	100	2 1/2	7,972	2.50
1950	105	+249	99	2 1/2	8,503	2.57
1951	122	+696	112	2 1/2	9,101	2.74
2nd Quarter 1952	131	+681 1/	122	2 1/2	9,412	2.76

1/ Estimate for entire fiscal year 1952. The fiscal year ends June 30 in the majority of the countries.
n.a. Not available

Source: International Monetary Fund, Institute National de la Statistique (France), l' Institute National de Statistique (Belgium), Instituto Centrale di Statistica, OEEC Fourth Annual Submissions, and miscellaneous sources.

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APPENDIX

Table 3

Internal Production and Expenditure

(at 1951 prices)

	Consumers' expenditures on goods and services	Government expenditures on goods and services	Gross fixed asset formation (public and private)	Gross national product at market prices
Belgium-Luxembourg				
(Billions of francs)				
1948	239.6	34.9	50.0	316.4
1951	257.6	43.2	57.4	269.4
1952-53p	251.6	56.5	60.9	371.2
1953-54p	260.4	58.3	63.2	284.3
Percentage change, 1953-54/1951	+ 1.0	+35.0	+10.1	+ 4.0
Netherlands				
(Millions of guilders)				
1948	13,980	2,690	4,070	18,937
1951	13,435	3,155	4,465	21,685
1952-53p	13,970	3,720	4,300	22,590
1953-54p	14,250	3,800	4,400	22,970
Percentage change, 1953-54/1951	+6.1	+20.4	-1.5	+5.9
Italy				
(Billions of lire)				
1948	5,536	943	1,631	7,850
1951	6,840	1,047	2,029	9,760
1952-53p	7,030	1,100	2,106	10,075
1953-54p	7,215	1,130	2,168	10,376
Percentage change, 1953-54/1951	+5.5	+7.9	+6.9	+6.3

APPENDIX

Table 3 Continued

	Consumers' expenditures on goods and services	Government expenditures on goods and services	Gross fixed asset formation (public and private)	Gross national product at market prices
France				
(Billions of francs)				
1948	6,970	1,142	2,205	9,985
1951	7,766	1,591	2,234	11,774
1952-53p	8,207	2,004	2,242	12,475
1953-54p	8,450	2,115	2,320	12,865
Percentage change, 1953-54/1951	+10.9	+32.9	+3.8	+9.3
Denmark				
(Millions of Danish kroner)				
1948	15,900	2,400	4,600	22,600
1951	17,200	2,800	5,900	25,900
1952-53p	17,700	3,200	5,800	26,600
1953-54p	18,000	3,500	5,800	27,300
Percentage change, 1953-54/1951	+4.6	+25.0	-1.7	+5.4
Sweden				
(Millions of Swedish kroner)				
1948	21,370	3,830	5,960	31,470
1951	22,431	4,610	6,435	35,806
1952-53p	23,350	5,200	6,900	36,600
1953-54p	23,750	5,400	7,100	38,100
Percentage change, 1953-54/1951	+5.9	+17.1	+10.3	+6.4
Norway				
(Millions of Norwegian kroner)				
1948	10,152	1,543	5,458	17,277
1951	11,566	1,839	5,955	20,080
1952-53p	12,000	2,230	5,970	20,600
1953-54p	12,500	2,350	6,250	21,250
Percentage change, 1953-54/1951	+8.1	+27.8	+5.0	+5.8

p - OEEC projection of member country

Source: Fourth Annual OEEC Submissions of Member Countries