BANK FOR INTERNATIONAL SETTLEMENTS

TWELFTH ANNUAL REPORT

1st APRIL 1941 — 31st MARCH 1942

BASLE

8th June 1942

TABLE OF CONTENTS

ANNEXES

TWELFTH ANNUAL REPORT

OF THE PRESIDENT OF THE BANK FOR INTERNATIONAL SETTLEMENTS TO THE ANNUAL GENERAL MEETING

held at

Basle, 8th June 1942.

The President has the honour to submit herewith the Annual Report of the Bank for International Settlements for the twelfth financial year, beginning 1st April 1941 and ending 31st March 1942. The results of the year's business operations are set out in detail in Chapter VII. Net profits, after provision for contingencies, amount to 5,185,685.90 Swiss gold francs. After the allocation to the Legal Reserve that is required by Article 53 of the Statutes, to an amount equal to 5 per cent. of the net profits, i. e. 259,284.30 Swiss gold francs, there remain available for the payment of a dividend 4,926,401.60 Swiss gold francs, corresponding to nearly 4 per cent. of the paid-up capital. The Special Reserve Fund has been drawn upon to the extent of 2,573,598.40 Swiss gold francs in order to permit the distribution of an annual dividend of 6 per cent. The balance-sheet total has fallen from 495.8 million Swiss gold francs to 476.6 million Swiss gold francs on 31st March 1942, the fall being due to reductions in various categories of deposits.

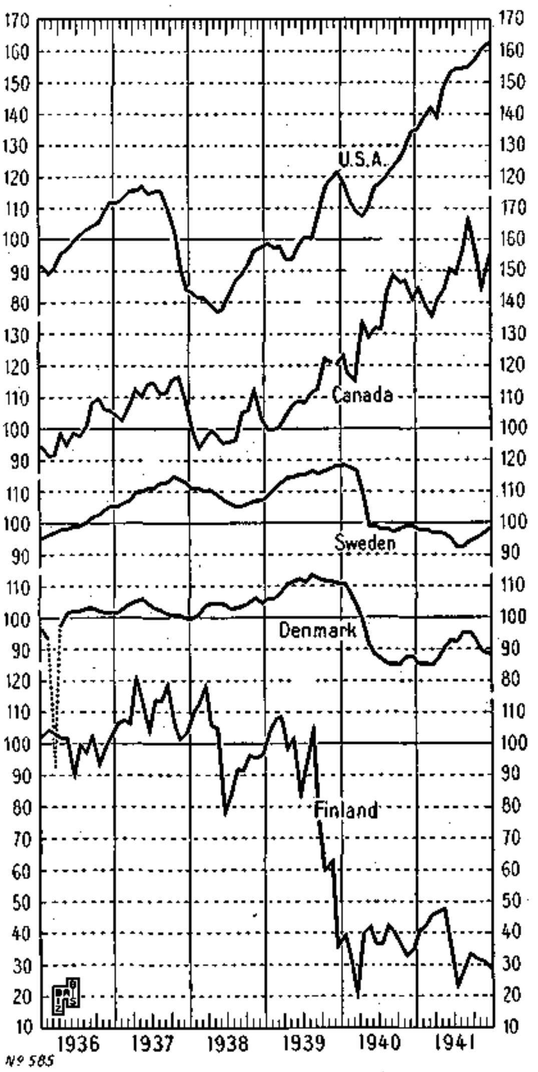
The volume of current business undertaken by the Bank for International Settlements has been further curtailed in the year under review by the extension of the area of hostilities and the intensification of economic and financial warfare. As regards operations still possible, including the management of the Bank's investments on various markets, the Bank has continued to receive the assistance of central banks and other monetary institutions with which it is in contact. In its activities, the Bank has constantly adhered to the principles of scrupulous neutrality which it laid down for itself in the autumn of 1939, avoiding all transactions whereby any question could possibly arise of conferring economic or financial advantages on a belligerent nation to the detriment of another.

The present conflict has indeed become a world conflagration: by the end of 1941 countries having no less than 90 per cent. of the entire population of the world were actually involved in war, the population of neutral and non-belligerent countries making up the remainder in the proportion of 6 per cent. in Latin America and 4 per cent. in isolated countries scattered over other parts of the world. The wide compass which the war has thus taken has naturally had a profound influence on all economic life: through the interruption in commercial and financial relations, the world has been divided into a series of separate trade areas; and, through the tremendous diversion of resources in men, materials and machinery from civilian to military ends, the ordinary mechanism of economic activity has been transformed with a speed and to an extent never before known.

Mindful of the lessons of the last war, the belligerent countries have not pursued a policy of "business as usual". From the very beginning they instituted a measure of control similar to that which developed only gradually during the years 1914–18. This does not mean, however, that there have been no changes in economic policy. As will be shown more fully in Chapter II, Germany and the United Kingdom, during the first stages of the war, were both intent on furthering their exports in order to pay for essential imports. Germany for some time retained her system of export subsidies and the United Kingdom favoured exports in a number of ways (inter alia the 14 per cent. depreciation of sterling in August–September 1939 had that effect). But, under the strain of the war effort and with the growing scarcity of goods, the imperative necessity of augmenting domestic resources by the greatest possible surplus of imports soon became evident. Germany was able to use her stronger commercial and military position on the continent of Europe while the United Kingdom mobilised foreign resources and, in addition, obtained lend-lease assistance from the spring of 1941; the two countries were thus in a position to exchange their initial export drive for a policy of exporting only the minimum needed to satisfy the essential requirements of the countries with which trade was still maintained.

In other countries there has been a similar shift in emphasis from stimulation of exports to increased attention to imports. This change is characterised by such measures as abolition of import prohibitions, suspension or reduction of customs duties, a freer allocation of exchange for imports of vital commodities, appreciation of currencies, etc. while, in commercial negotiations, it has become increasingly the primary objective of each party to cover at least the minimum requirements of the most-needed supplies. But imports for one country are exports for another and, in so far as imports are not counterbalanced by visible or invisible exports, arrangements must be made for credits or other forms of assistance. Between nations on the same side in the war, steps have been taken to ensure that financial considerations do not limit the flow of war materials and other important commodities (arrangements between Germany and Italy, Germany and Finland, lend-lease assistance, the gift of $1,000 million by Canada to the United Kingdom, etc.). Neutral countries have used the granting of credits as a means of bargaining to obtain indispensable supplies and transport facilities. Fears that an inflow of goods would cause unemployment or hamper the growth of home industries belong to the past; with the great wartime demand for labour, the governments have even become less concerned with the need of safeguarding foreign markets in order to provide employment for their export trades; and import control, where maintained, is primarily used to select, for the limited transport possibilities available, the most important commodities among those which can still be obtained. In general, efforts are made to compensate for the loss of foreign supplies by a diversified home production. Thus in Latin American countries, cut off from the continent of Europe and affected by changes in the Pacific, industrialisation has been vigorously pushed, but is retarded by the difficulty of obtaining the necessary machinery. The connection between exchange control and import policy as forced upon the Latin American countries may be seen from the following quotation out of the annual report of the Banco Central of the Argentine Republic for the year 1941: "Thus it was that to a considerable extent the origin of our imports ceased to be determined by reasons of price, quality or the individual preferences of the consumer and they were forcibly diverted towards those countries with which we had an exchange balance which had to be used up. Such exchange could not any longer be used freely to effect payments or purchases in other countries but had to be utilised in the country which had originated it by its purchases. The exchange permit, as well as being a means of restriction of imports, thus also became a selective instrument and, in the light of experience, it can be affirmed that this second function was often more important than the original one."

Indexes of Industrial Production
on base 1936 = 100.



The rise in productive power, which began with the industrial revolution over a century ago, has enabled the modern state to devote an increased proportion of the national output to war purposes before encroaching upon the minimum needs of civilian consumption. Total warfare, when brought to its logical conclusion, requires the utmost mobilisation of economic strength both by direct intervention in the field of production and by the impact through the budget on the distribution of resources. The magnitude of present war efforts is reflected in the overwhelming proportion — up to 80 per cent.

in the main belligerent countries — of war expenditure in relation to the total budget, and also in the high proportion of the national income now taken by the state.

Estimates of national income are not easy to form at a time of rising prices and of rapid change in the pattern of economic life. On the other hand, much greater efforts have recently been made to obtain promptly as reliable data as possible although not all the available information is published. Indexes of production, for example, are made public for only a limited number of countries. There are several ways of relating government expenditure to the national income, each one appropriate for its own particular purpose; only in international comparisons is it difficult indeed to be sure that the same method has been applied to the different data used. This difficulty is increased when governments receive contributions from abroad, since in such cases the methods of compilation usually vary considerably. The difficulties cannot be wholly overcome, but, even so, the proportions between, for instance, government expenditure and the amounts available for consumption are useful in throwing light on some of the main problems of war economics (with allowance made for the amount of error involved in the estimates).

According to a German estimate*, the total public expenditure (central and local) in Germany amounted to RM 100 milliard for the year 1941, with private consumption at RM 70–75 milliard. Public and private spending together thus reached RM 170–175 milliard, corresponding to a net national income of RM 110–115 milliard, an amount which, in the first place, has to be increased by RM 32–35 milliard to account for transfers of income and for the effect of indirect taxes on prices. To the net national income must also be added an amount of RM 15–17 milliard, representing contributions from abroad to the German war-financing and to the supply of commodities for the German economy (including credits in clearing), and a further amount of RM 5–10 milliard, being the estimated value of drafts on accumulated domestic resources (domestic disinvestment).

For the United Kingdom, figures covering roughly the same categories of expenditure and drafts on extraordinary sources for the calendar year 1941 may be extracted from the White Paper issued with the new budget in April 1942. Total public expenditure (central and local) amounted to £5,100 million and personal expenditure on consumption (at market prices) was given at £4,550 million. £800 million were obtained as drafts on capital from abroad (so-called "overseas disinvestment", excluding lend-lease), while "domestic disinvestment" was estimated at nearly £500 million.

Although the figures for these two countries must not be strained for a detailed comparison, it is impossible not to be struck by the similarity of the general proportions. In both, the total public expenditure is higher than the amount available for personal consumption; in both, the extraordinary

* In an article by Dr. G. Keiser on "National Income and War Financing", in "Bank-Archiv", 15th February 1942.

contributions from abroad covered about the same proportion of the public expenditure; in Germany, domestic disinvestment is estimated at 5 to 10 per cent. of the public expenditure and, in the United Kingdom, at nearly 10 per cent. It may be added that, in the two countries, about one-half of the total public expenditure (central and local) requiring domestic finance is covered by current revenue (mostly taxation). The conclusion would seem to be that, under the conditions of total war obtaining in Germany and the United Kingdom, the mobilisation of resources has been pushed well-nigh as far as is compatible with the limits set by the economic and social structure. For other countries too, the same conclusion would hold good; but corresponding estimates of total public and private spending from current income and drafts on capital are not usually available. In Italy, total public expenditure can currently be estimated at Lit. 100 milliard with a net national income calculated in Italy at Lit. 140 milliard. The Japanese capital mobilisation for the financial year 1942–43 is based on an estimate of the national income at Yen 45 milliard, of which the government plans to take Yen 24 milliard. When, in January 1942, the President of the United States submitted the budget to Congress for the financial year 1942–43, he estimated that the war expenditure would absorb about 50 per cent. of the current national income; total public expenditure — central and local — in the United States would thus attain about the same proportion to available resources as in other countries which became belligerent at an earlier date. Indeed there appear to be certain necessities which, so to say, dominate the financial and economic problems created by a total war.

(i) Total spending of the government and for private consumption is not kept within the limits of the current national income but drafts are unhesitatingly made on capital wealth. That this should be the case is, in a way, self-evident: if maximum effort is to be attained, all the resources that can be made available must be brought into play. At home, drafts on capital are effected by postponement of replacement, maintenance and even repairs, or by depletion of merchandise stocks. After the war all this must naturally be made good. It has been pointed out* for Germany that the lowest estimate, namely that every war year would give rise to accumulated replacements costing RM 5 milliard, needed correction in that, from a certain point, wear and tear increase geometrically. In all the belligerent countries there are no doubt important additions to plant and equipment in the armament sector, but such additions are part of the specific war effort and do not as a rule permanently increase the volume of productive resources; for that reason the fiscal authorities normally permit a very rapid amortisation (in the United States within five years) of new investments in war industries. Depletion of merchandise stocks was an important feature in the first two years of the war but, with the prolongation of hostilities, the importance of this source is being rapidly reduced.

Borrowing abroad and the utilisation of foreign assets (whatever effect such a mobilisation of resources may ultimately have) bring, of course, valuable immediate aid. The United Kingdom drew heavily on its monetary

* In a speech by Dr. Lüer, head of the Wirtschaftskammer Hessen, reported in the Frankfurter Zeitung, 22nd October 1941.

reserves and easily realisable assets on the American market and had practically exhausted its readily available foreign resources by the time that lend-lease assistance was granted by the United States early in 1941.

In this war few foreign loans and credits have been arranged with private lenders. As a rule the governments themselves furnish the funds direct from their Treasuries or through separate agencies; but sometimes they prefer to offer their exporters so-called export guarantees, covering the exchange and credit risks up to a certain percentage, or they attach such provisions to the clearings that exporters can confidently look forward to payments within a certain time. The countries benefiting from the various credit arrangements will as a rule have no repayments to make while the war lasts.

(ii) In the second place, it has been found impossible to meet wholly by current revenue the tremendously swollen military expenditure of countries engaged in total warfare. To provide for as much as one-half of the total state expenditure by current revenue already demands a very great effort. This time taxation has been increased much more resolutely than in the last war, when during the earlier stages there was a distinct reluctance to impose new taxes, the idea apparently prevailing that the war must be made popular at all costs. In the years 1914–18 the United Kingdom covered about 20 per cent., of the total government expenditure by taxation, and Germany only 13 per cent. In the present war, income tax, together with surtax and excess profits duties, has been made the mainstay of the revenue side of the budget; these taxes have been raised to heights never known before, with the double aim of procuring income for the state and of preventing private enrichment in the midst of a public calamity. There is, however, a dilemma involved in the imposition of very high rates, since at a certain point these rates may too radically eliminate the money motive and thus weaken one incentive to increased effort and more economical production.

Another difficulty arises from the fact that the increase in the income structure during a war emergency is very largely among the lower income groups, which can be less easily subjected to heavier direct taxes. Under the influence of growing armament expenditure, national income in the United States rose from \$77.1 milliard in 1940 to \$94.5 milliard in 1941 (approximately one-third of the rise being due to higher prices). Of the increase amounting to \$17.4 milliard, not less than \$12.1 milliard or 70 per cent. represented income gained by employees, aggregate salaries and wages expanding as the combined result of increased employment, higher wage rates and longer hours. In the United Kingdom, there has also been a remarkable shift in the income structure: wages (excluding salaries but including pay and allowances of soldiers below the rank of officers, in the armed forces and auxiliary services) constituted, before the payment of taxes, 39 per cent. of the national income in 1938 and 48 per cent. by the end of 1941. At the latter date not less than 85 per cent. of the aggregate income retained by the public after the payment of income tax and surtax was the share of persons with an income of £500 a year or less. In Germany, where the price and wage-stop policy has prevented an all-round increase in wage rates, it has been explained officially that, owing to increased overtime, more work by women and payments to persons serving in the armed forces, as well as the earnings of foreign workers, the money income of large sections of the population has nevertheless been raised by several milliards. For absorbing as much as possible of this expansion in purchasing power and providing revenue for the state, an increase in indirect taxation has proved to be the most practical method at the disposal of the authorities. In addition to the heavy income tax and excess profits duties which have been imposed, especially in the higher income brackets, excise duties have accordingly been raised and, in a number of countries, turnover taxes (usually at an effective rate of at least 5 per cent. of the retail prices) have been introduced, providing, inter alia, a compensation for the sharp drop in customs receipts caused by the shrinkage in international trade. The actual yields of turnover taxes, which, of course, bring in increased revenue as commodity prices rise, have regularly exceeded expectations. In wartime, governments are hardly in a position to choose between different methods of raising revenue; the amounts needed are so tremendous that all sources must be tapped. From the point of view of fiscal justice, it is not sufficient to examine the incidence of individual taxes but the combined effect of all the tax changes must be taken into account, increased indirect taxation being counterbalanced by the heavy direct taxes which, from the beginning of the war, have been imposed on higher incomes.

(iii) In the third place, the part of government expenditure not met by current revenue has become so great that peacetime rates of voluntary saving in no way suffice to finance the deficits in the budgets. In the United Kingdom, for instance, the total of net savings was estimated at £220 million in 1938, while, in 1941, £1,520 million had to be financed by borrowing on the home market (over and above the proceeds from extra-budgetary funds and local-authority surpluses, and compensation in respect of war-damage claims). During a national emergency the propensity to save is no doubt strengthened by appeals to patriotism and by greater prudence in personal spending, but the amounts which can be raised through loans placed with the public and with insurance companies, savings banks, etc. as a rule fail to meet the government need of borrowed funds. With few exceptions, the public Treasuries have been obliged to borrow at the central bank and from the commercial banking system, although well aware that such borrowing leads to an expansion of the amount of money balances in the hands of the public. The problem then is how to prevent the increased amount of money from being spent on goods and services the supply of which has been reduced by the war, or, in other words, how to increase saving.

One method has been to introduce a system of "forced" savings. In the United Kingdom, the budget for 1941–42 provided for a reduction in the so-called personal and earned-income allowances (deducted from income for the calculation of income tax), while the amount of tax levied as a result of this reduction was credited to the taxpayer in the post office savings bank, to be repaid sometime after the war. In 1941–42 these post-war credits came to £60 million. In addition, 20 per cent. of the amount paid as excess profits tax (levied at the rate of 100 per cent.) will be returned to the taxpayer for certain purposes after the war; in respect of taxes paid in 1940–41, the amount thus to be returned would seem to be about £50 million.

Another form of forced saving may be exemplified by the system introduced in Italy in the spring of 1942, under which certain excess profits must be invested in 3 per cent. government securities, blocked for the duration of the war. In a number of countries "forced loans" have been issued (see Chapter V); whether they actually entailed an increase in current savings is, however, often somewhat doubtful.

Since the war began, Germany has not imposed any form of "forced" savings but, in the closing months of 1941, two new types of voluntary investments, provided with specific fiscal advantages, were introduced to tie up purchasing power: the first, a deposit in savings and other banks, for small savers; the second, a deposit at the Treasury, of surplus funds accumulated by industrial and other firms as a result of postponed repairs and replacements or set free by the reduction of stocks. Considering the loss of revenue connected with these investments, the extent to which they are permitted has been made subject to definite limitations. Up to the end of March 1942, the first type of investment had produced RM 250 million and the first tranche of the second type RM 700 million — not inconsiderable amounts but, of course, of slight fiscal importance at a time when the current needs of the state rise to RM 8 milliard per month, covered up to one-half by current revenue and one-half by borrowing.

To bring about the necessary contraction in private spending, other methods, amounting in practice to an indirect form of securing compulsory savings, have been applied. By a system of rationing and sweeping restrictions on private investments, income-earners are prevented from utilising in full the amount of money at their disposal. Possession of money no longer in itself enables a person to consume goods — he needs, in addition, a ration card or a special permit from the authorities. Sheer inability to spend thus gives rise to "savings": the more comprehensive the rationing system, the more compelling the pressure to save. In countries where the "free sector" is still rather wide, indirect compulsion is perforce less effective in securing the required volume of savings. Whatever the extent of the free sector, it is usually subjected to heavy indirect taxation. In the United Kingdom, the budget for 1942–43 sharply increased the duties on beer, spirits, wines, tobacco and entertainments, and doubled the rate of the purchase tax to $66^2/_3$ per cent. of the wholesale value of a wide range of "luxury" goods. The first general restrictions imposed in the United States after that country had become involved in the war were applied to the production of such durable consumers' goods as automobiles, refrigerators, radios, etc., which require materials directly in competition with armaments. It was in the purchase of these goods that, up to 1941, consumers' demands had been most considerably expanded, following the increase in the national income; the amount spent on them in 1941 came to somewhat more than $10 milliard. With the exception of certain selected household items — a small proportion of the total — their production for civilian use was rapidly curtailed in the winter of 1941–42.

How much has consumption fallen since the war began? An official of the German Institute for Economic Research arrives at the conclusion that the actual amount of money spent in Germany on consumption was about the same in 1941 as in 1938*. But in the latter year the population in the "Alt-Reich" was 75.4 million, while in the present "Reich" area it amounts to 92.7 million; moreover, the cost-of-living index rose from 1938 to 1941 by 6.7 per cent., and account has also to be taken of the fact that, during a war, some deterioration in the quality of the goods sold is unavoidable. The author points out that the reduction in consumption implied by these facts has been most uneven: there has been hardly any decline in housing accommodation or in the provisions which the agricultural population consume from their own output; and, for large groups of the town population (those engaged in heavy work, families with children), consumption even under rationing is not much less than in peacetime. The consequence is that other sections of the community are correspondingly more affected.

In the White Paper issued together with the British budget for 1942–43, it is estimated that the reduction in the volume of consumption in 1941, compared with 1938, "probably lies within the limits of 15 and 20 per cent.". A similar reduction is found in Sweden: an estimate by the "Konjunkturinstitut" puts the contraction in the volume of private consumption from 1939 to 1941 at 15 to 20 per cent. In European countries other than the three just mentioned the decline in consumption has as a rule been more pronounced, the gradual exhaustion of stocks and the bad harvests both in 1940 and 1941 being two important factors. There is, of course, a minimum below which the health and possibly the life of a people is affected; there is a higher level — difficult to determine — below which the efficiency of the workers is impaired and production consequently begins to suffer.

The demands of war are great and imperative: in one way or another, what the governments need must be taken from the public. If it is taken by methods which lead to considerable and cumulative inflation, not only is the social structure put to a serious strain but the war effort itself may be hampered by disorganisation of the whole economic and financial system. The problem of restricting private spending can be tackled in two ways: from the goods side and from the money side. By the first method, the governments seek to limit purchases by such measures as rationing, the importance of which can hardly be overrated. The other way is to absorb, by taxation and borrowing, the excess amount of money in the hands of the public. But not all forms of government financing achieve this purpose; some even make matters worse. Indeed, there is, so to say, a hierarchy among different methods of raising money from the point of view of their effectiveness in counteracting inflation.

---

* In an article by Dr. W. Bauer in "Europa-Kabel", 22nd May 1942.

(i) Taxation is no doubt the most effective method to restrict spending, provided that account be taken of the manner in which the increase in money income is distributed among the people: if profits are swollen, more revenue can and should be raised through income and profit taxes; on the other hand, if profits are kept down but wages increased, the new taxation must, to achieve its purpose, fall largely upon the mass of wage-earners.

(ii) Borrowing of genuine current savings from the public, either directly or through such institutions as insurance companies, savings banks, etc. also has as its counterpart an effective reduction in spending by the public.

Taxation and borrowing of genuine savings do not on balance affect the money income of the community, or the amount of money outstanding, or indeed the liquidity of the banking system, since the funds taken from the public flow back when spent by the government.

(iii) Borrowing of funds accumulated in the past, as, e.g., when a bank balance of long standing is drawn upon in order to subscribe to an issue of government bonds, is not neutral in quite the same way: when the government spends what it has borrowed, the total money income of the community is increased (since the subscription was not based on current savings); but there will be no increase in the total volume of money balances; nor is the liquidity of the banking system directly affected.

(iv) Borrowing from commercial banks, either by selling them government securities or by taking up direct credits, corresponds to no reduction in either the spending power of the community or the volume of money (cash and bank balances) in the hands of the public. On the contrary, spending by the government of funds borrowed from commercial banks will tend to increase the money income of the community and the total of cash and bank balances. True, bank-notes may be hoarded and bank balances may not be drawn upon, i. e. the public may save in the form of holding notes and bank balances, but the amounts thus held are not tied up, being spendable at any time that goods can be obtained. Lending to the government tends to reduce the liquidity of the commercial banks (their liabilities increasing but not their cash). The banks, however, count holdings of Treasury bills as a highly liquid asset (often rediscountable at the central bank) and can strengthen their cash position by allowing some of these bills to run off; besides, the central bank may step in and provide increased cash through its own open-market operations in order to enable the banks to continue their lending to the government.

(v) The greatest degree of danger attaches to direct borrowing by the government from the central bank, thus swelling the money volume and money income of the community and either expanding the note circulation or increasing the liquidity of the banking system. In the latter case, the banks, having to carry the costs of increased deposits and in many cases to pay interest on funds deposited with them, may seek to acquire more revenue-producing assets and further increase the volume of their lending, thus entering on a secondary expansion of credit. (To counteract such a tendency, measures have been taken in Denmark, among other countries, to tie up more effectively the increased cash reserves of the commercial banks.)

The above list is not complete. For instance, governments may borrow funds arising from a net repatriation of capital. But the cases included in the list illustrate the most relevant point: what happens to the total amount of money (cash and bank balances) in the hands of the public and to the liquidity of the banking system as a whole? Perhaps the most practical single distinction is between those operations which absorb part of the money volume already in the hands of the public — (i), (ii) and (iii) in the above list — and those which add to that volume — (iv) and (v) above. It may be possible theoretically to neutralise a continued expansion in money balances by a strict and well-nigh all-inclusive system of rationing, completely preventing the new money from being spent on goods and services; but the burden of withstanding inflation would then be thrown entirely on measures affecting the goods side. Those who are actually in charge of price control in different countries invariably emphasise the necessity of attacking the problem from both sides. Thus, the German Price Commissioner* refers to the lack of balance between the amount of money in the hands of the public and the available volume of goods — some not subject to rationing — and adds: "Since from this lack of balance a tendency arises to offer higher prices for all goods still available, so as to obtain them in preference to other purchases, the absorption of excessive purchasing power is an element of decisive influence in price policy".

The restrictions designed to enable the state to obtain command of the purchasing power in the hands of the public also include **measures taken to reserve for the government the bulk of loanable funds in the money and capital markets.** In wartime the government becomes the main — almost the sole — borrower; it holds, in fact, a monopoly position, export of capital being prevented by exchange restrictions and the domestic credit machinery being controlled, not necessarily by detailed orders but by an understanding on certain general principles with banks and other credit institutions. Thanks to its monopoly position and with the aid of the central bank, the government is able to fix, within certain limits, the rates applicable to its own borrowing. At a time when public debts are piling up to unprecedented heights, it is naturally in the interests of each nation that money should continue to be cheap. The cost of raising new money on government account (at short and long term in the present proportions) is under 3 per cent. in Germany and under 2 per cent. in the United Kingdom and the United States. But, notwithstanding the obvious fiscal interest of the state, there has been some reaction recently against too low interest rates, partly because it is believed that savings may thereby be discouraged and partly on account of the adverse influence on life assurance companies and social funds and, through the narrowing of interest margins, on the banking system. In February 1941 an official statement was made in Germany, intimating that there was no

* In an article published in "Der Vierjahresplan", 15th March 1942.

intention, for the time being, of seeking a general lowering of the standard rate of 3½ per cent. for long-term Reich borrowing. The directors of the Swedish Riksbank issued a memorandum on monetary policy in November 1941; in this they stated that a further decline in the rate of interest should not be contemplated, nor was a rise justified, and they indicated as desirable the present level characterised by a yield of 3½ per cent. on long-term government bonds and 1 per cent. on 3-month Treasury bills. Steps have, moreover, been taken in a number of countries to give an increased remuneration to amounts from small savers, sometimes with the added advantage of tax exemption.

If there is some limit to the fall of interest rates for government borrowing it is natural that restrictions should be placed on other borrowers, who might take undue advantage of temporary wartime conditions to convert outstanding debts. This falls within the province of the capital-issue control; in Germany a number of conversions have been allowed to reduce the rate on mortgage bonds and the loans of local authorities to a 4 per cent. basis; in England certain conversions by local authorities and public utility undertakings have been permitted, generally to 3½ per cent. Similar conversions (as a rule involving no new money) have been allowed elsewhere but generally within well-defined limits; in Holland in March 1942 permission to convert mortgage-bank bonds to a rate below 3½ per cent. was officially refused. But, in spite of these reactions, money is still cheap as judged by earlier standards and seems likely to stay so while the war lasts.

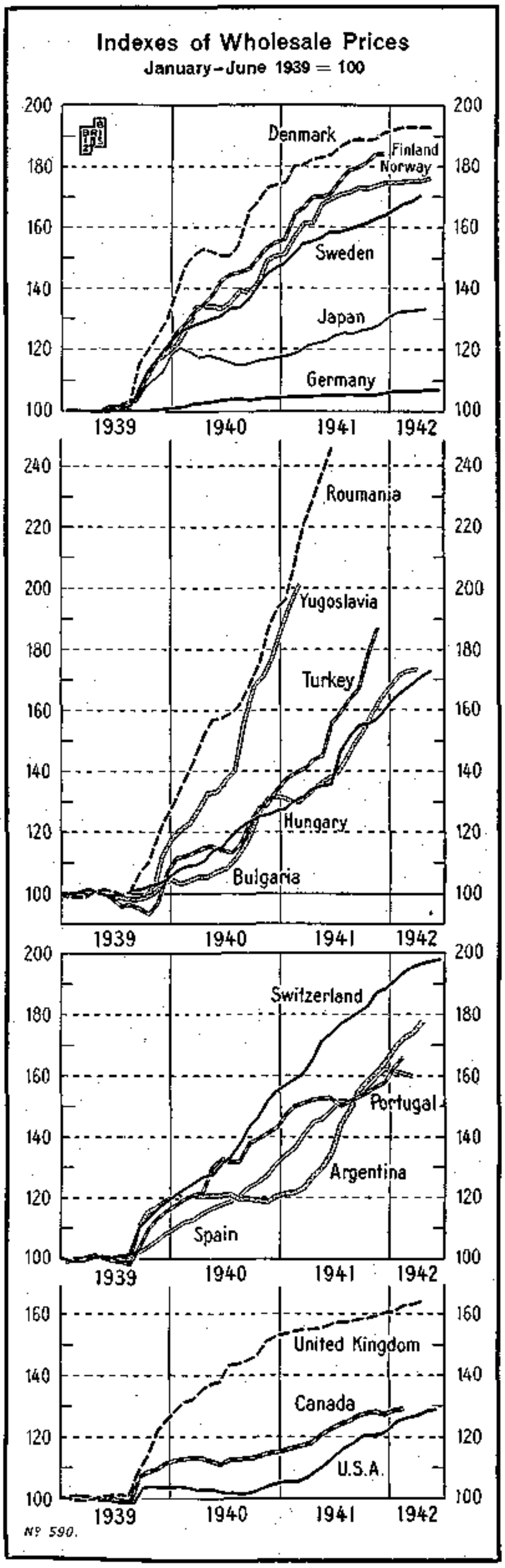
With regard to the future, both the British Chancellor of the Exchequer and the President of the German Reichsbank have said that cheap money will continue to be the official policy when the war is over. But it is obvious *that, with the great demand for capital which may be expected when that* time comes, in order to carry out the tasks of reconstruction (including the repair and replacement of plant and the replenishment of stocks in industry and commerce), conditions may arise which will make the uninterrupted reign of cheap money more difficult to maintain. Special steps may have to be taken to ensure a large volume of savings even after the war — which means, inter alia, that for some time the public as a whole must not expect to be able to use for its immediate needs the purchasing power piled up during the war. Technically, the post-war situation will be the easier for the government to handle, the more the purchasing power now engendered is tied up at long term instead of being "saved" in the form of bank-notes and bank deposits. It is natural, therefore, that, with interest rates already very low, governments should turn their attention to lengthening the maturity dates of their borrowing rather than seek to borrow even more cheaply. Maturity dates on long-term government loans have been lengthened during the past year in the United States, England and Germany, and the "iron savings" in the last country have also the object of tying up small savings more effectively than is the case with savings-bank and other deposits.

The rate of interest, however, is not merely the price paid for loanable funds. It has a wider rôle as a capitalisation factor in determining the value of capital assets and, under normal conditions, as one of the factors which influence the direction of production. For the time being, net industrial and other profits are kept down by heavy taxation, and production is arranged to suit the supreme needs of the state. But it is perhaps not altogether feasible to eliminate all those influences which ordinarily help to establish a proper balance in a country's economy. For the government to press down interest rates or to hold them at an exceptionally low level, the commercial banks must as a rule acquire large blocks of government securities; and, to make such acquisitions possible, they must be provided with plentiful cash balances. If care is not taken, this liquidity may easily become excessive from a monetary point of view, provoking a diversion of funds to other purposes. A clash between fiscal and monetary considerations may indeed arise even in highly controlled markets, since wherever an outlet is still possible the weight of *money may make itself felt in all its force.*

Thus in a number of countries the mounting volume of liquid funds has sought an outlet in the purchase of capital assets, particularly shares, the prices of which have sometimes risen to such levels that the authorities have seen fit to intervene. The measures then taken are explained by a determination to prevent a flight from the currency. At a time of growing tension between increased supplies of money and reduced supplies of goods, when the public must be induced to buy government securities or at least to leave its money unspent with banks and other credit institutions, confidence in the currency becomes a question of prime importance. In the final analysis, this confidence can be sustained only if the new money issued to the public will in the future retain its power to purchase goods and services without any too substantial impairment. Price policy and monetary policy thus go hand in hand. Psychologically, the task of maintaining confidence is now rather more difficult than in the last war, since even in 1919 it was still generally believed that all the main currencies would regain their pre-war parities, the long era of monetary stability before 1914 having made people forget what inflation was and what its effects might be. For this reason, among others, a much more drastic supervision of prices has now become necessary.

While in the sphere of public finance and money and capital markets a great similarity is found between conditions and methods in various countries, a glance at the graph of movements in wholesale prices and the table on the cost of living will show that, in regard to commodity prices, there is a marked difference between the virtual stability in Germany and the considerable increases which have taken place in most other countries. To illustrate the main points which have arisen, some account must be given of the developments in a few countries.

Already in 1936 Germany had introduced a "price-stop" system, by which an increase in prices above the level prevailing on 17th October of that year, without the approval of the Price Commissioner, was forbidden. At the beginning of the war the prohibition was extended to wages and in 1940 to



profits also. Leaving aside the many technical problems which arise, the basic principle is that all elements which go to make up the prices of finished articles shall be subject to control. The Price Commissioner has explained that prices have only very rarely been increased for the purpose of stimulating production; a rise has been authorised only when conditioned by increases in costs which could not be avoided by the producers and would then, as a rule, have to be borne by the consumers; government subsidies to keep prices down have, however, been granted in a certain measure where the support given would help to free the consumers from anxiety and thus eliminate far-reaching repercussions on the whole price structure.

Prices being prevented from rising, the necessary contraction in civilian consumption is effected by rationing and similar measures; and the transfer of labour from one occupation to another, since it is not brought about by wage differentials, has to be ensured largely by official orders, the right of the individual worker to move freely from one employment to another being strictly circumscribed. It follows that the success of the German system depends less on the ordinary functions of the cost and price structure than on sound and comprehensive official direction, the efficiency of the control, and the cooperation and discipline shown by the business world and the general public.

In some respects the task of holding down prices has been rather easier in Germany than in other countries. Firstly, price control was in operation before the war started; secondly, Germany had already developed the home production of many substitutes for goods previously imported and had adapted her domestic prices to the costs of this production (it being the characteristic of substitutes not that they are necessarily inferior to the ordinary commodity but that more effort is needed to procure them; if they can be procured as advantageously as the ordinary product they cease to be substitutes); thirdly, the exchange value of the Reichsmark in clearings and payments agreements in the 'thirties had been kept at the gold parity with a price level which, calculated over the official exchange rates, was higher than in other countries. This made Germany somewhat less susceptible to the price rise in other European countries. (Elsewhere, it was usually discovered only after some time that, in order to secure imports, it is advantageous to have a currency with a high exchange value — hence the recent tendency in several countries to appreciate their currencies.) But, even with these various advantages, the German resistance to price rises would not have had its high degree of effectiveness had not the control been extended to wages and profits and applied with unremitting vigour.

Percentage Increase in Cost of Living
from June 1939 to December 1941.

Germany	+ 5
United States	+ 11
Argentine	+ 11
New Zealand	+ 12
Australia	+ 12
India	+ 21
Japan	+ 21
United Kingdom	+ 28
Portugal	+ 33
Sweden	+ 34
Switzerland	+ 34
Hungary	+ 39
Norway	+ 43
Denmark	+ 51
Bulgaria	+ 60
Roumania	+145*

* To August 1941.

In other countries, where substantial price increases have occurred — often contrary to the efforts of the authorities, not to mention the interests of the consumers — the effect has been, however, that at least to some extent the normal functions of the cost and price system have continued to operate. From 1939 to 1941 the cost of living in Sweden rose by 30–35 per cent. and the money income of the public by nearly 10 per cent., the margin between the increase in the cost of living and the increase in the money income roughly corresponding to the decline in the supply of consumers' goods, and thus providing, so to say, a natural balance between supply and demand. In Switzerland, a government commission appointed to advise on price and wage problems gave as its opinion in August 1941 that "in a wage policy applied with discrimination and not as a stereotyped process, the national economy possesses a useful instrument for the direction of production". Wages of Swiss industrial workers have advanced on an average by one-half of the rise in the cost of living, according to the principle that no compensation can be given for that part of the increase in living costs which is due to a greater scarcity of goods and services (since the effects of such a scarcity must be shared by all). The rise in pay being more pronounced in some occupations than in others, wage changes have no doubt helped to attract workers to expanding industries. It has been found, however, that each upward adjustment of wages has in its turn an influence on prices. Moreover, when changes in remuneration are permitted, each particular group, whether as producers or as consumers, is naturally anxious to ensure that it will not be left behind. The diversity of interests is often most clearly brought to the fore in the determination of prices of agricultural products; when these prices are allowed to rise, the cost of living is immediately affected, and this leads to a demand for higher wages by industrial workers and others.

The effects of the British price policy may be shown by a comparison between movements in the first two years of the present and the last war.

Comparison between Price Developments in the United Kingdom
in 1914-16 and 1939-41.*

Period	Percentage change in			
	Wholesale prices (Statist)	Retail price of food	Cost of living	Wage rates
From July 1914 to July 1916. . .	+ 58	+ 61	+ 45	+ 17
From August 1939 to August 1941	+ 61	+ 20	+ 28	+ 21

* From an article by A. L. Bowley in the London and Cambridge Service's Report on Current Economic Activities, November 1941.

While the rise in wholesale prices was about the same during the first two years of both wars, retail prices of food have this time been kept down by regulation and by extensive government subsidies, costing the Exchequer £125 million in 1941. This policy has been adopted in order to make it possible to moderate the rise in wage rates and thus to resist an upward tendency in the whole cost and price structure. There is no hard and fast prohibition against wage increases, but official participation in wage negotiations has become the rule and, in some branches, as, e. g., agriculture, the wage rates have been determined by official bodies.

Except for a sudden rise by 5 per cent. at the outbreak of war, there was little change in the level of wholesale prices in the United States up to the end of 1940; and there was hardly any increase at all, up to that date, in the cost of living. But in 1941 wholesale prices advanced by 17 per cent. and living costs by 10 per cent. Simultaneously, hourly wage rates in the manufacturing industries were raised by about 15 per cent. and, because of longer hours, overtime rates, promotions, etc., the average pay envelope contained 20 per cent. more than in the previous year. Farmers, as a group had an even larger gain, increasing their income by not less than 40 per cent. A record expansion in the output of consumers' goods provided the counterpart of the increase in purchasing power, but already in the latter half of 1941 the production of durable consumers' goods (especially automobiles) began to be restricted in favour of the armament programme. To slow down price increases, especially on materials vital to armament production, a Price Commission was instituted in May 1940, but its powers were limited; it was only by the Emergency Price Control Act adopted in January 1942 that the Price Administrator was empowered to establish "ceilings" for any commodity and for housing accommodation within the defence areas. But agricultural commodities were still accorded special treatment, the farmers insisting on higher prices to compensate them for past losses in the lean years of agricultural depression. As government spending increased, absorbing between one-quarter and one-half of the national income, it was felt that the established price control would not be sufficient. In April 1942 the President in a message to Congress, recommended the adoption of a seven-point programme including, inter alia, provisions for stabilisation of the remuneration received by individuals and stabilisation of agricultural prices. The responsibility for the stabilisation of wages devolves upon the National War Labor Board, the Chairman of which has announced that the Board will not freeze wages but "will not allow them to get out of hand". Demands for wage increases will be dealt with more strictly, but the Board will continue to adjust inequalities and pursue a policy of raising sub-standard wages.

The countries have thus gone different ways in finding the relationship between movements in living costs and in wages, but there is no doubt a growing tendency to stabilise a certain level of remuneration, ensuring the satisfaction of minimum needs by an extended system of rationing at regulated prices. In Switzerland and a few other countries, among them Italy, compensation for higher living costs has been granted not by a uniform increase in wage rates but by a more flexible system, according to which the lower and some of the middle wage groups have been given special consideration, while for higher income groups the adjustments have been on a smaller scale. The extent of the compensation has also been made in a large measure proportionate to the family burden. In other countries too, the granting of family allowances seems to have made headway under the strain of war conditions.

Rationing serves a triple purpose: (i) to ensure an equitable distribution of foodstuffs and other essential commodities; (ii) to counteract a rise in prices by cutting down demand and (iii) to reduce spending and thus increase savings. As regards the prices of rationed goods, the authorities are often in a difficult dilemma: on the one hand, retail prices must be within the means of those for whom the goods are destined; on the other hand, wholesale prices must not be so low as to discourage production. Up to a point, subsidies may be used to pay the producers without raising the price for the consumers, but subsidising has its limits. Although no belligerent country can rely solely on the price system to secure the reallocation of resources necessary for the pursuit of the war, it would obviously be dangerous to allow the price relationship to develop in such a way as would tend to retard the changes to be effected.

Government control over prices and the distribution of essential commodities is not equally effective in all countries. Under the strain of the war, the industrial population has less to offer in return for agricultural products, which may induce farmers to hold back supplies, as was indeed the tendency in some areas during the later stages of the 1914–18 war and the following inflation period. For a system of rationing to function satisfactorily, it is imperative that the rationed goods should be available in the right places and in the allocated quantities and that these goods, together with those obtainable in the legally free markets, should suffice for the most elementary needs of the consumers. When these conditions are not fulfilled, it becomes almost impossible to prevent a resurgence of the black markets, socially and otherwise so dangerous. In some countries there are already price levels, so to say, "on two floors": one official, at the prices prescribed by the control, and one illegal, in the black market. The actual prices paid in the latter — often two or three times as high as the official prices — not only reflect the exceptional shortage of the goods dealt in and the excessive purchasing power in the hands of the public but also contain a risk premium on account of the illegality of the transactions. Because of this premium, black-market prices are undoubtedly too high to represent what would be a "natural" price level, supposing there were no control.

When the war is over and goods gradually become available in increased quantities, the question will arise which price level is to be decisive for the future. There will be everywhere a reduced supply of goods for some time to come, together with an abundance of cash and deposits that can be turned into cash. One of the problems will be to prevent the pent-up purchasing power from causing a post-war inflation, lifting prices well above the level reached while the war lasted. It is usually taken for granted that government control over prices, the distribution of essential goods, etc. must be maintained for some time after the war. But the influence of control is mostly in the nature of "brakes", and in the transformation from war to peacetime economy it is most important that productive forces should be allowed to exert their full dynamic influence, not least in order to cope with the problem of unemployment. Government action to sustain the volume of national income by a policy of public works and by other means is being planned in many countries as part of the post-war programme. It is realised that such works must be correctly timed to fit into the trend of post-war business (held back, should there be a "boom", but expanded in case of a marked decline in activity). It is also recognised that changes in the channels of trade when the war is over may necessitate cost adjustments from exceptionally high levels reached during the war, in order to bring goods within the consumers' reach and to restore the export trade. As a rule the countries which have been most successful in reviving industrial activity and getting rid of unemployment have been those which combined a policy of suitably-timed financial expansion with a policy of cost adjustment and in that way managed to establish a true balance within their own national economies and in relation to other countries. Great importance is attached to mobility of labour and flexibility generally in industry, without which it will be hard indeed to transfer workers from war production to peacetime occupations and to employ those who return from war service. The governments will have to concern themselves with these matters; the problem is perhaps not so much to decide to what extent they should intervene as to fix the main purpose of their intervention: to aid in the transition to a balanced peacetime order instead of simply protecting vested interests, whether of capital or labour.

The acuity of the post-war difficulties will depend on many circumstances which cannot yet be foretold, such as the length of the war, the destruction still to come, etc.; but in some respects the financial policies now pursued should make the solution of a certain group of post-war problems somewhat easier than was the case after the last great war. The task of restoring a proper balance between government revenue and expenditure may, for instance, prove less difficult this time: once specific war expenditure has disappeared there should be sufficient budget revenue to meet current requirements, thanks to the more effective taxation imposed during the present war. Another important difference is that much more drastic steps have been taken this time to prevent borrowing for speculative purchases of real estate, acquisition of shares, etc. There can be little room now for the unbridled speculation which characterised the later stages of the 1914-18 war and the post-war boom period. The banks and business men generally have not forgotten the losses which followed an expansion that could not be sustained when the war was over. They have continued the policy, begun during the depression in the 'thirties, of strengthening their liquid positions, thus being better prepared to meet the trials of a possible post-war slump. Official support for this development is usually given by more generous provision for tax-exempt allocations to industrial depreciation funds.

It is perhaps permissible to hope that, in laying the foundations for a durable peace, a more general attempt will be made to avoid a repetition of those major monetary and economic errors which proved so harmful after the last war, it being borne in mind that mistakes may not show their effects all at once but, like a time bomb, produce disaster suddenly at a later date. Modern production provides the technical means for fairly rapid reparation of the merely material destruction caused by the war. But the attainment of a higher general welfare presupposes in the first place a rebuilding of the economic organisation distorted and disrupted by the war — a task made more complex than in the past by the growing interdependence of political, social and economic factors.

II. EXCHANGE RATES, FOREIGN TRADE AND COMMODITY PRICES.

1. EXCHANGE RATES.

The year under review has been characterised by a great stability in the rates of foreign exchange, due to a stricter application of control by monetary authorities and to increased arrangements for credits (in clearings and otherwise) to take care of disequilibria in the balances of payments. In the individual countries efforts have been made to withstand inflationary tendencies, and a growing inclination to appreciate, rather than depreciate, currencies may be regarded, under present circumstances, as part of this stand against inflation. The steps taken in Hungary and Bulgaria to bring the valuation of the so-called "free currencies" into line with that of the Reichsmark led to an appreciation of the pengö and the lev in terms of these free currencies (most typically represented at the moment by the Swiss franc). The Danish crown was appreciated by about 8 per cent. in January 1942. In a number of Latin American exchange markets the quotations of "free rates" were brought closer to those of the official rates.

In two countries the value of the currency has been defined anew in terms of gold. In July 1941 the gold contents of both the new Serbian dinar and the new kuna in Croatia were fixed at 0.0179 grammes of fine gold as against 0.0265 grammes in the case of the old Yugoslav dinar.

Under the increased control to which the foreign exchanges have been submitted, the ordinary play of supply and demand in the exchange markets has been more and more eliminated, and at the same time transfers of gold and foreign exchange, by which temporary disequilibria in the balances of payments were prevented from causing wide fluctuations in rates, have come to play only a secondary part. In their place, credit transactions adapted to the present exceptional conditions have gained in importance. Lend-lease aid by the United States, the supply by Canada of materials, munitions and foodstuffs free of charge to the United Kingdom, and other such arrangements tend to divorce the shipment of goods from the ordinary machinery of foreign exchange settlements. Where clearings are in force, either the individual creditor to whom a payment is due has to wait until his turn arrives in the list of notified claims in which case he extends a credit to the country of his debtor; or the clearing authority, in order to shorten delays, makes arrangements for advance payments, itself granting a credit to the country unable to make immediate payment in full. It has often been said that the main purpose of a clearing is to provide for an equilibrium in the payments between the two clearing partners. As the system has developed, the clearings have, however, more and more become a medium for the extension of credits, permitting a continuation of exports notwithstanding an insufficient return of imports.

On the continent of Europe most of the foreign trade is carried through clearings — in Switzerland, 70 per cent., elsewhere rather more. In each clearing agreement some provision must be made for the rate of exchange at which the claims are to be accounted: sometimes the countries have bound themselves to apply a fixed rate for the duration of the agreement; often, however, it is stipulated that the daily quotations in the exchange market shall be the basis for the accounting of the claims and in this case each partner remains free to alter unilaterally the exchange value of his currency. It may happen that a country has concluded some agreements stipulating a fixed rate and other agreements with a rate based on market quotations; if so, it has tied itself more firmly in relation to certain countries than to others.

But whether or not a country is formally free to modify the exchange value of its currency, it will naturally seek contact with its most important clearing partners before it proceeds to do so. In 1940 and 1941 negotiations were carried out between Germany and countries in the Danubian and Balkan areas for the purpose of bringing the exchange valuation of the Reichsmark more into line with the quotations of the dollar, the Swiss franc and other "free currencies". By a complicated system of premiums of varying magnitude, these countries had tried in the years before the war to stimulate exports payable in "free exchange", with the result that the effective rates for the Reichsmark did not correspond to those for the free currencies. Through a series of changes in the latter half of 1940 the discount of the Reichsmark had, however, been limited to a maximum of about 20 per cent.: in some cases the premiums applicable to the Reichsmark had been raised; in others the premiums on the sale or purchase of the free currencies had been reduced; in yet other cases a combination of these two methods had been employed. In 1941 further steps were taken to eliminate the discount on the Reichsmark and again the method varied from country to country. In Greece, uniformity was attained by an increase in the quotations of the Reichsmark and the lira, while the rates applied to free currencies remained practically unchanged. In Hungary and Bulgaria, the premiums granted in respect of free currencies were brought down, while the Reichsmark rate remained practically unchanged; in these two countries the lira counted among the free currencies. Finally, in Serbia and Croatia, the quotations of the Reichsmark and the lira were increased but not to the full extent of the previous discount, the quotations of the dollar, the Swiss franc and other free currencies being somewhat reduced.* No uniformity in the valuation of the Reichsmark and other

* The following indications may be given to show some of the complications of the currency changes in south-eastern Europe. Upon the reorganisation of the monetary system in what had been Yugoslavia, a reduction of 32.5 per cent. was made in the gold content of the dinar (and the kuna) but the effective depreciation of the dinar in terms of "free currencies" had occurred at an earlier date: account being taken of the various premiums on foreign exchange, the quotation of the dollar had been gradually raised to Din. 55 instead of Din. 33.53 at the old parity (adopted in 1931). At the new parity adopted in June 1941 the official dollar rate was brought back to Din. 50; in relation to the dollar (and the other free currencies) the dinar was thus appreciated by just over 9 per cent. At the new parity the Reichsmark became equal to Din. 20 (and Kunas 20) instead of Din. 17.82 as previously; in relation to the Reichsmark the dinar was depreciated by 10.9 per cent. After the occupation in the spring of 1941, the rate of the Italian currency was at first fixed at Lit. 30 = Din. 100 (compared with Lit. 43.70 at the old clearing rate) but in connection with the monetary reorganisation in July the rate was changed to Lit. 38 = Din. 100 (and Kunas 100), which corresponds to the new gold content of the dinar (and the kuna). Of the old Yugoslav territory, certain parts were attached to Italy, Germany, Hungary, Roumania and Bulgaria, so that, together with the new Serbia and Croatia, the old area of the Yugoslav currency became subject to seven different currency arrangements.

currencies has yet been adopted in Roumania, where a 90 per cent. premium is applied to the Swedish crown and the Swiss franc; for a number of other currencies fixed rates are in force; the Reichsmark is quoted at Lei 59–60, which in fact corresponds to a premium of about 38 per cent. Commercial relations between the United States and the countries in south-eastern Europe having been cut off since the summer of 1941, the dollar rate is no longer of direct practical interest, but the quotation of the Swiss franc and some of the other rates, which have moved in conformity with the dollar rate, are still of importance.

The following table summarises the changes in recent years.

Swiss Franc and Reichsmark rates of Danubian and Balkan currencies.

Countries	Average rates (1) in national currencies on								
	July 1, 1940			April 1, 1941			April 1, 1942		
	Sw.fc	RM	% premium of Sw.fc	Sw.fc	RM	% premium of Sw.fc	Sw.fc	RM	% premium of Sw.fc
Bulgaria	25.42	32.75	27	23.78	32.75	20	19.02 (2)	32.75	0
Greece	34.20	46.50	23	34.20	48.50	18	34.20	60.00	—2
Hungary	1.18	1.62	23	1.19	1.66	19	0.98	1.66	2
Roumania.	48.27	49.50	42	44.00	59.50	22	44.13	59.50	22
Yugoslavia . . . . (Serbia, Croatia)	12.33	14.80	33	12.63	17.82	18	11.60	20.00	0

(1) Averages between the rates for sale and purchase, including premiums.
(2) Without premium.

In most of these countries commodity prices have risen considerably but the intensity of the upward movement has varied from country to country. The danger is, of course, that the newly-agreed exchange relationships do not for long correspond to the purchasing power of the different currencies. For the time being, almost all of these countries have clearing claims on Germany which would be sufficient to ensure the exchange value in relation to the Reichsmark — the currency of their most important trading partner — but one-sided price increases must in the long run, here as elsewhere, exert an influence on the exchange position.

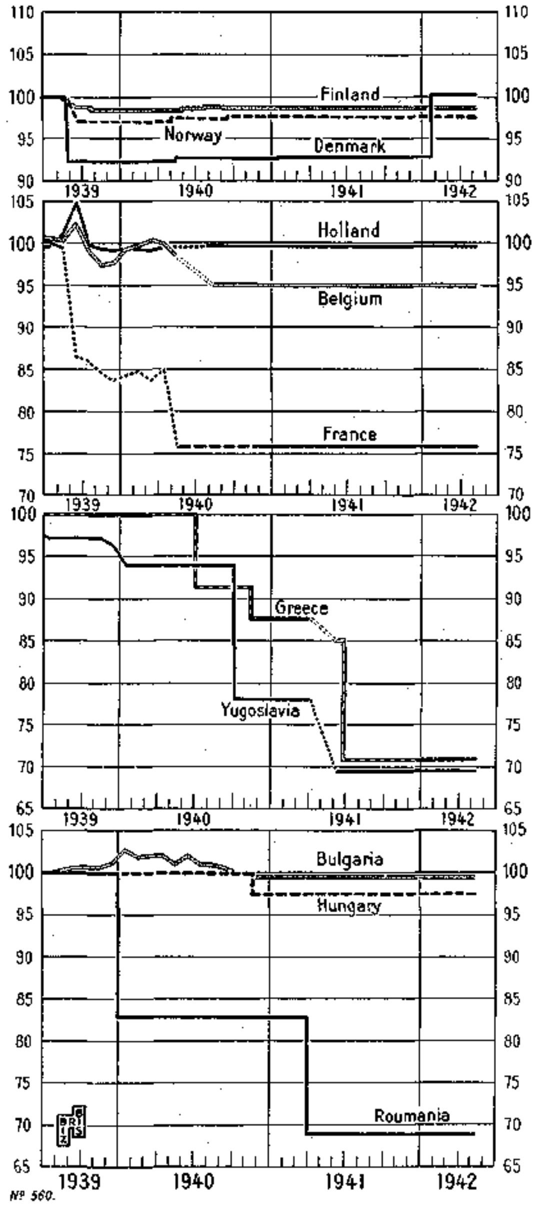
Considerations of price and cost movements as influenced by the foreign exchanges were the main motive behind the appreciation of the Danish crown in January 1942. It will be remembered that on the outbreak of the war in 1939 the exchange value of sterling depreciated by 14 per cent. and that the Danish crown followed this decline to the extent of 8 per cent. in order to safeguard the country's export position on its then most important market. In relation to Germany, Danish commodity prices had been low already before the war, and the depreciation of the crown in 1939 made them lower still. Trade with the British Isles having been cut off in the spring of 1940, Germany acquired a predominant position in the Danish export trade; in order to harmonise with the German level, commodity prices in Denmark would then have had to be adjusted upwards. To limit the extent of the necessary adjustment, it was decided, after negotiations with the German monetary authorities, to appreciate the crown sufficiently to restore the pre-September-1939 relationship between the two currencies; that is what happened in January 1942. It should be mentioned that Danish farmers had been averse to the revaluation since they feared a fall in the prices of their products. The Danish authorities were, however, able to come to an agreement with Germany under which the prices of Danish agricultural products in terms of crowns were to be maintained unchanged, except in so far as agricultural prices were reduced by cheaper imports of fertilisers, etc. In that way a decline in agricultural income was avoided, while prices were held down in other branches of the economy. It was also expected that the revaluation would have a beneficial psychological influence, help to increase confidence in the currency and thus stimulate saving.

When a country alters the exchange value of its currency, some repercussion on the terms of trade with other countries is almost inevitable, and there are instances of steps taken by these other countries to neutralise the effects of the currency change. Thus, in connection with an alteration of the exchange rate by the Protectorate of Bohemia and Moravia, the Slovak Government, from the beginning of October 1940, imposed a 16 per cent. duty on exports to the Protectorate, and out of the proceeds Slovak imports from the Protectorate were subsidised. In that way it was hoped at least to lessen the influence of the new exchange rate on the domestic price level, since the export duty would counteract a rise in the price of goods exported and the revenue from this duty would serve to keep the prices of foreign goods down. At the beginning of October 1941, when Hungary reduced the premium on purchases and sales of free currencies, including the lira, with the consequence that the pengö rate in Italy was raised from Lit. 385.2 to 468 per Pengö 100, the Italian Government decided to equalise this change by the imposition of a tax of 20 per cent. on payments made by Hungary to Italy and in particular on payments for deliveries of Italian goods. The proceeds are used to encourage imports from Hungary.

Switzerland has also introduced similar measures. They were first employed in relation to Spain (from March 1940); in the spring of 1942, the export charge amounted to 10 per cent., which, including commissions, etc. made an increase of 12 per cent. in the invoice price. The proceeds were used to subsidise imports from Spain at rates ranging from 8½ to 25 per cent. of the value of certain specified commodities. In October 1941 a similar system was introduced in relation to Finland; in the spring of 1942 the export duty was 12 per cent. but import premiums had not been fixed in detail. After the Bulgarian lev had been appreciated in terms of the Swiss franc in the autumn of 1941, the Swiss Government imposed an equalisation charge of 30 per cent. on exports to Bulgaria, granting import premiums ranging from 15 to 58 per cent. on sheep leather, eggs and scrap copper; the premiums have, however, no general validity but are fixed after an examination of each particular business transaction for which support is requested. It is also of interest to note that in January 1942, when the Danish crown was appreciated by about 8 per cent., the Swiss authorities made it known that they were prepared to impose a duty on exports to Denmark, in order to be able to subsidise imports from that country; but no such step was taken, the Danish Government offering to guarantee that the most important commodities which Switzerland obtains from Denmark (eggs, seeds, fish and horses) would not be subject to any price increase in terms of the Swiss franc, notwithstanding the appreciation of the Danish crown.

These instances show a growing preoccupation in many countries with regard to the influence on the domestic price level of currency changes abroad and also a growing readiness to adopt countermeasures against the price raising tendency of such changes. At the time of the discussions in Denmark and Hungary regarding an appreciation of the currency to mitigate the rise in prices, the question was raised in other countries also whether a currency appreciation might not be a suitable expedient for holding down the domestic price level. In a speech in May 1942, the President of the Swiss National Bank pronounced himself against the adoption of such a measure and added that, in the opinion of the National Bank, the imposition of an export duty to be fixed according to the circumstances of each particular case, together with premiums granted to importers, constituted a more appropriate method of equalisation whenever the margin between the costs of imports and the receipts from exports became too large.

Clearing rates in relation to the Reichsmark, on base January–June 1939 = 100.

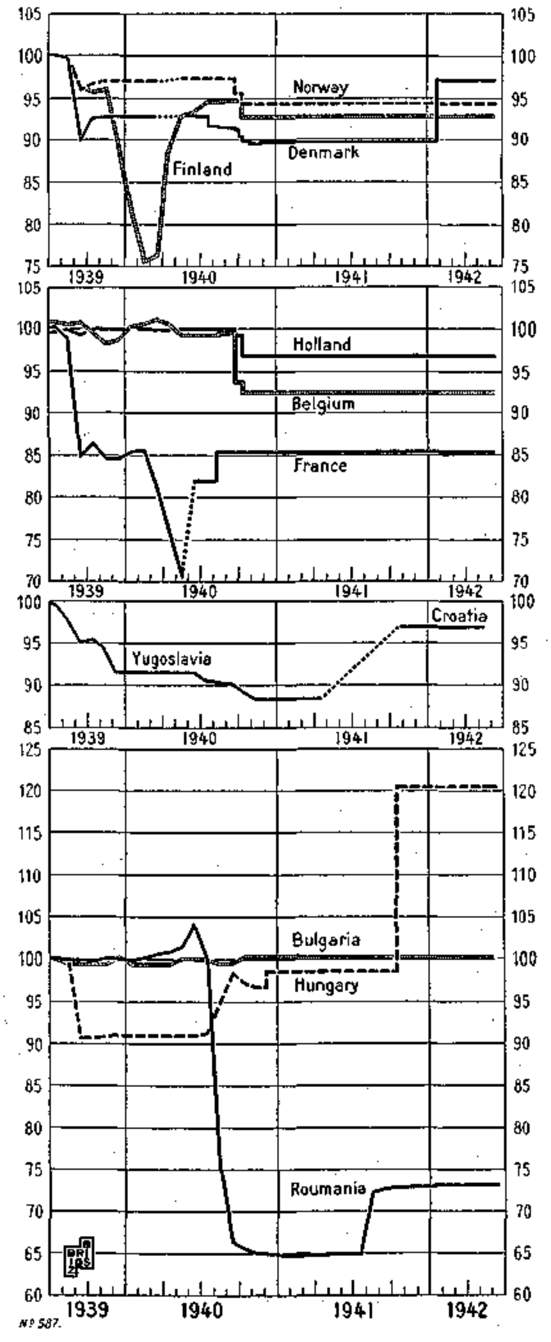


Apart from the currency changes in south-eastern Europe and the appreciation of the Danish crown mentioned above, there have been no important modifications of exchange values in Europe.* The two graphs on these pages show the exchange values of a number of European currencies in relation to the Reichsmark and the Swiss franc since the summer of 1939.

In relation to the average rate for the Reichsmark in the first half of 1939, the leu, the dinar and the drachma have depreciated by about 30 per cent., the French franc by 24 per cent. and the Belgian franc by 5 per cent., while in the spring of 1942 the quotations of the other currencies shown in the graphs (the guilder, the pengö, the lev, the Norwegian and Danish crowns) were within 3 per cent. of the quotations ruling before the beginning of the war.

In relation to the Swiss franc, the following currencies show broadly the same variations as in relation to the Reichsmark: the Belgian franc, the guilder, the Finnish mark, the Danish and Norwegian crowns, but the picture changes as regards the French franc (only depreciated by 14 per cent. against the Swiss franc), the dinar, which in the form of the Croatian kuna has almost regained its 1939 value against the Swiss franc, the pengö, which, in relation to the Swiss franc, has been appreciated by 21 per cent., and the leu, the depreciation of which against the Swiss franc is somewhat less than in relation to the Reichsmark. In the two graphs the rates of the Bulgarian currency are shown

Clearing rates in relation to the Swiss franc,
on base January-June 1939 = 100.



* In the eleventh Annual Report mention was made of the decision taken in Italy at the end of May 1941 to raise the dollar rate from $5.05 = Lit. 100 to $5.26¼, i. e. to the rate in force before September 1939. At the same time corresponding adjustments were made in the quotations of a number of other currencies (including the Reichsmark, the Swiss franc and the Swedish crown) and in that way a greater uniformity was attained in the European system of rates and cross rates.

at an unchanged value, the rates stipulated in clearing agreements having remained the same all through the period. From 1933, however, the Bulgarian National Bank has paid certain premiums in respect of so-called free currencies (including the Swiss franc but not the Reichsmark). In August 1939 these premiums were unified at a level which involved the recognition of a depreciation in the value of the lev by 26 per cent. Through a new arrangement in December 1940, the premiums for the free currencies were, however, somewhat reduced; and, by a decision taken in November 1941, these premiums were abolished; in that way the lev was brought back to its old par value also in relation to the free currencies. It should, however, be mentioned that, for certain transition periods of six to twelve months, special provisions have been adopted to allow existing commitments to be liquidated with the benefit of the old premiums.

One of the main reasons for the introduction of greater uniformity in the European exchange structure, especially as regards the valuation of the Reichsmark and the so-called free currencies, has been the desire to facilitate the working of a multilateral clearing over Berlin. By the beginning of 1942, seventeen out of twenty countries on the continent of Europe were in one way or another linked to the central clearing in Berlin, Portugal, Spain and Turkey being the only exceptions. Belgium and Holland settle with each other via the clearing in Berlin and, in addition, via Berlin with Bulgaria, Croatia, Denmark, Finland, France, Greece, Hungary, Italy, Norway, the Governor-Generalship of Poland, Roumania, Slovakia, Sweden and Switzerland. France clears with Belgium, Holland and Norway via Berlin but with other countries direct. Norway uses the clearing in Berlin for settlements with Belgium, Bulgaria, Croatia, France, Finland, Greece, Holland, Hungary, Italy, the Governor-Generalship of Poland, Roumania and Switzerland but settles direct with Denmark and Sweden. The Governor-Generalship of Poland passes through Berlin for its payments to Belgium, Bulgaria, Croatia, Greece, Holland, Hungary, Italy, Norway, Roumania and Switzerland; and Serbia settles via Berlin with Bulgaria, Croatia, Hungary, Italy and Roumania, i. e. with all the neighbouring countries. Bulgaria and Roumania also settle their mutual payments via Berlin.

It has been reported that the volume of transactions cleared for the account of European countries through the "Verrechnungskasse" in Berlin had been trebled from September 1940 to the spring of 1942. One of the vice-presidents of the Reichsbank explained in May 1942*, with regard to the development of the bilateral clearing system into a multilateral clearing, that in wartime this system could hardly be expected to function without friction, since that presupposed a balancing of exports, which could not always be achieved, but that conditions would be different when the enormously increased productive capacity of Germany was turned over to peacetime goods after the war.

Traditional methods of settling balances by transfers of foreign exchange were profoundly modified in 1939 by the introduction of exchange control in

* Der Deutsche Volkswirt, 22nd May 1942.

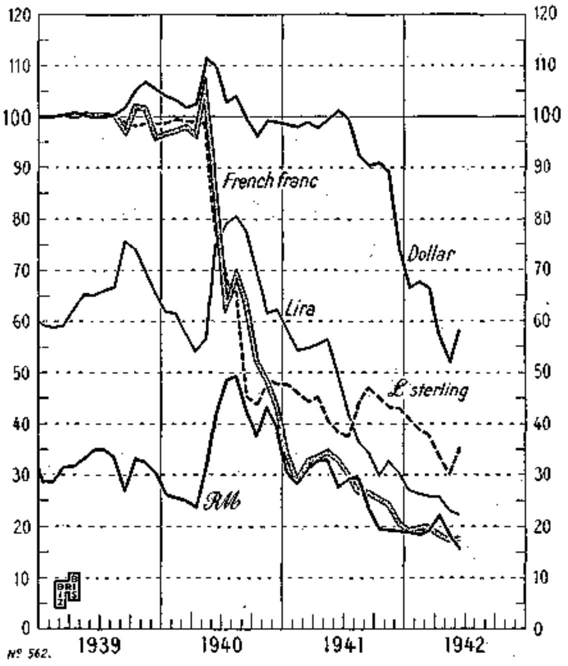
the United Kingdom, and again in 1941 by the extension of the freezing of dollar assets to all countries on the continent of Europe. Beginning with an order dated 10th April 1940, the United States Government imposed freezing on the dollar assets of Norway, Denmark, Holland, Belgium, Luxemburg, France, the three Baltic States and Roumania; at the same time, quotation of the currencies of these countries was discontinued on the New York market. In 1941, the assets of the following countries were made subject to freezing: Bulgaria, on 4th March; Hungary, on 13th March; Yugoslavia, on 24th March; Greece, on 28th April; and on 14th June: Finland, Germany, Italy, Portugal, Spain, Sweden, Switzerland, and all other countries on the continent of Europe; China and Japan, on 26th July; Thailand, on 9th December; and Hong Kong, on 26th December. To be able to dispose of frozen assets, the owner must obtain a licence from the Treasury Department, Washington. General licences may be granted and have been obtained by Sweden, the Swiss National Bank, Spain and Portugal. These licences all include the provision that no payment or transfer may be made which is on behalf of or pursuant to the direction of any blocked country or nationals thereof.

Under the licence given to it, the Swiss National Bank has the right to dispose of dollars for transactions with countries whose assets are not blocked and to accept dollars invested in the United States when offered to it by Swiss citizens. As all countries on the continent of Europe are subject to "freezing", the dollars cannot be used for payments to them, and special licences for such payments are given only in most exceptional cases. For the time being, both the dollar and sterling have in fact ceased to serve as media for international settlements in Europe. Instead, greater use is made of gold; in the main, however, debit balances are less and less met by payments in a universally accepted medium but are left to accumulate as clearing "Spitzen" or lead to other forms of credit.

Rumours of an extension of the freezing of dollar assets to all countries on the continent of Europe had been circulating months before the decision was taken and had been one of the reasons for a rapid repatriation of dollar funds to Switzerland and to some other markets in Europe. From the middle of 1940 up to 14th June 1941, the Swiss National Bank had been obliged to absorb large quantities of dollars which were offered to it. (If it had not done so, the dollar rate might have been subject to fairly wide fluctuations.) In order to limit its dollar purchases, the National Bank asked the Swiss banks in January 1941 to offer it only such dollars as belonged to persons domiciled in Switzerland. Even after 14th June 1941 a surplus of dollar balances arising from Swiss exports to the United States, or otherwise at the disposal of the owners, continued to be offered on the Swiss market. In the autumn of 1941 the National Bank concluded with the Swiss banks a convention according to which dollars needed for imports to Switzerland were to be provided exclusively out of dollars derived from Swiss exports (and certain other privileged transfers such as payments of insurance premiums, maintenance charges etc.). Any balance arising from weekly settlements would be taken over by the National Bank. The convention does not apply to dollars from purely financial transactions. The Swiss National Bank does not regard it as desirable that its dollar reserves should be increased on account of financial transfers in proportions which might be considerable. For dollars which the National Bank has absorbed, it has paid a minimum of Sw.fcs 4.30, and the convention with the banks provides for a range of rates from Sw.fcs 4.23 to 4.33. Dollars of which the Swiss owners may dispose (as e. g. income from dividends, etc.) but which are not bought by the banks may still legally be dealt in on the market, and different rates are then quoted by dealers other than the banks. These transactions are often settled via New York, where the rates quoted have at times been equivalent to Sw.fcs 3.30.

After the United States had become involved in the war, the actual shipment of dollar notes from Europe to the States became difficult to arrange. On 13th March 1942, moreover, the Treasury Department took action to control the importation of foreign and domestic currency into the United States from any blocked country not falling within the general-licence trade area or from nationals of enemy and certain other countries. Upon importation, such currency must be forwarded immediately to the Federal Reserve Bank of New York as fiscal agent of the United States. The Federal Reserve Bank will thereafter hold the currency until the Treasury Department has authorised its release. As a result of these limitations in the free transfer of notes, dollar notes have been quoted in Europe well below par. In the spring of 1942 they could at one time be bought in Switzerland at the rate of Sw.fcs 2.00.

Quotations of Foreign Bank-Notes in Switzerland
as percentage of clearing or free rate.



Since it has become a regular feature of currency regulations to impede a repatriation of notes, quotations of notes follow their own course, uninfluenced by official intervention. In April 1942 a new decision in France reduced the amount of French bank-notes which a traveller may bring into the country from Fr.fcs 1,000 to 200; and at the same time it was prescribed that the export of notes in denominations of Fr.fcs 500, 1,000 and 5,000 either by travellers or by post could in no case be authorised. The graph shows the quotations on the Swiss market of the notes of five countries as a percentage of the clearing or free rates for the currencies in question.

In Sweden, the Sveriges Riksbank has maintained a fixed dollar rate of S.Kr. 4.20 since the autumn of 1939, absorbing the dollars offered to it (though with certain reservations in respect of larger transactions involving transfers of a capital nature). Sweden is a creditor country to a much lesser extent than Switzerland, and the Riksbank is therefore able to accept dollars more freely, even from financial transactions. The exchange control introduced in Sweden in February 1940 has been retained but its practical application has been eased by the fact that the supply of foreign exchange has exceeded the demand. Because of the existence of exchange control and because Sweden is little involved in international finance, the Swedish authorities are in a position to guarantee without much difficulty the exclusive Swedish character of the great mass of transactions in relation to the United States, and they have thus been able to avail themselves of a fairly comprehensive general licence covering the country's dollar transactions.

In Portugal also there has been a net gain of foreign exchange over the year, the escudo being more than ever in demand as a currency of increasing international importance. The exchange market in Lisbon has in principle been free from restrictions but has of course been indirectly affected by control measures in other countries.

The system of exchange control in the United Kingdom, which has been gradually perfected in the course of 1941, has remained unchanged in all its main principles. Thus, registered accounts were in operation with the United States and Switzerland with middle rates of $4.03 and Sw.fcs 17.35. The system of special accounts was extended to include the U. S. S. R. through a financial agreement signed in July 1941, establishing a centralised clearing account to be kept at the Bank of England in the name of the State Bank of the U. S. S. R. The rate applied is £ 1 = Roubles 21.38, corresponding to Roubles 5.03 = $ 1. Later in the year a special account was arranged with China also.

In 1940 certain steps had been taken to enable balances on bilateral accounts to be utilised for payments to third countries. Further progress was made along the same lines in 1941, particularly through a series of agreements concluded with the Central American republics. Under these agreements the trade and financial unit to which the scheme of payments was made to operate was extended to embrace them all, making it possible to compensate surpluses and deficits of the sterling area on a multilateral basis within this larger number of countries.

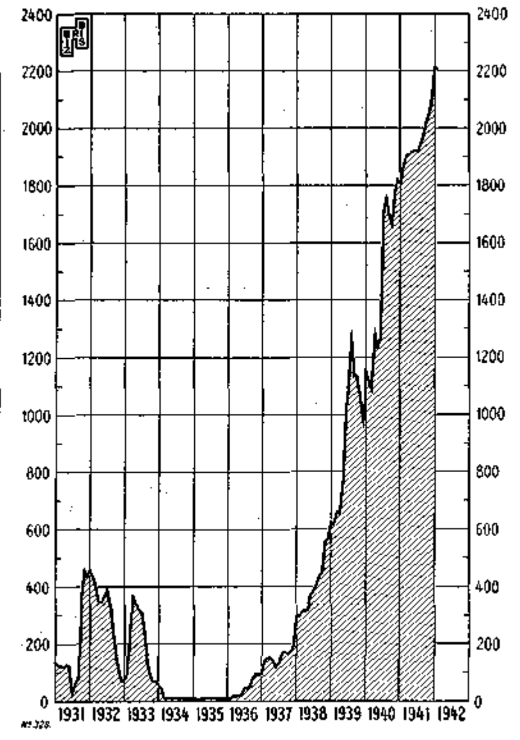
The sterling area was widened in 1941 by the inclusion of the Belgian Congo, Iceland and the Faroe Islands, French Equatorial Africa, the Cameroons, French Oceania, French Establishments in India, Syria and Lebanon, Irak and, on 1st August, Hong Kong, a colony which previously had been outside the technical arrangements for the sterling area. The Syrian currency remained at Fr.fcs 20, the relationship between the French franc and sterling being maintained at the old rate of Fr.fcs 176.625.

On the other hand, developments in the Far East in the winter of 1941–42 deprived the sterling area of Hong Kong, the Straits Settlements, Thailand and the Dutch East Indies. To facilitate payments by American troops in Australia, permission has been granted to visitors to the country to use any U.S. dollar currency which they have brought with them in their payments for goods and services. Persons in Australia receiving dollar notes under this arrangement are still required to resell them immediately to their bankers.

Canada and Newfoundland are technically outside the arrangements for the sterling area. The sterling-Canadian-dollar rate was kept at $4.43–4.47 all through 1941. Canadian dollars in New York fluctuated considerably during the year but with some improvement on balance. The lowest rate — 82¼ U.S. cents = Canadian $1 — was touched on 24th January and the highest — 89¾ cents — was reached on 8th September; at the end of the year the quotation was 86 cents. The Canadian and United States Governments have come to far-reaching agreements designed to stimulate the war production effort, suppressing customs and other barriers which impede the free flow of goods necessary for munition and war supplies between the two countries.

The exchange market in the United States has been affected by the freezing measures already mentioned above and the increased control over foreign financial transactions, generally caused by the entry of the United States into the war. An executive order of 26th December 1941 provided for automatic freezing of the assets of any territory in the event of its being occupied by countries at war with the United States. As a result of this and earlier orders a very considerable proportion of the gold held under earmark for foreign account by the Federal Reserve Banks is unavailable to the depositors. The volume of transactions in the foreign exchange market has shrunk, not only as a result of the freezing measures and the cessation of quotations for many currencies but also as a result of the increase in the business dealt with on official account without any foreign exchange counterpart. Through the Stabilization Fund and the Export-Import Bank further amounts have been granted as loans and credits to foreign — mainly Latin American — countries.

Gold held under Earmark by Federal Reserve Banks for Foreign Account, in millions of dollars.



In 1941, the Export-Import Bank undertook new commitments amounting to \$112.9 million — all in relation to Latin America. The largest loans were \$12 million to Colombia, mainly for the purchase of materials and equipment in the United States; \$11.3 million to the Cuban Sugar Stabilization Institute for the storage and sale of sugar; \$25 million to the Republic of Cuba for public works (mainly roads) and agricultural and mining developments and \$30 million to Mexico, of which part was for roads under a recent American-Mexican agreement. Although these loans are granted for specific purposes, they contribute generally to strengthening the exchange position of the borrowing countries. Moreover, there has been an increase in the shipment of goods to the United States, by which Latin America has been able to compensate itself in a large measure for the loss of trade with Europe. There is, however, a reverse to the medal: the cutting-off of trade with Europe and concentration of production on armaments in the United States have put obstacles in the way of imports, not only of finished articles but also of machinery and raw materials; thus the improvement in the trade balance has largely been due to an undesirable shrinkage in the supply of goods from abroad. To help to sustain the volume of imports there has been a general relaxation of restrictions and a freer allotment of exchange for import purposes.

In the Argentine certain modifications were made during 1941 in the system of government control over foreign exchange and the import of merchandise. The Exchange Control Office was abolished and its functions were mostly transferred to the Banco Central. Existing exchange rates were maintained, with the addition of the so-called "corporation rate", by which, in particular, more favourable exchange conditions were applied to imports from the United States.

Two exchange markets exist in the Argentine: the official and the free market. The free market, which is of limited importance, derives its exchange from various sources, such as travellers' sales of foreign currencies. The official exchange market obtains its exchange from the sales to the government of the entire proceeds of Argentine exports. The official buying rate is fixed at Pesos 3.36 for the U. S. dollar but, in some cases, a higher rate is paid to stimulate the export of certain specified articles. There are four official selling rates:

(i) a preferential rate of Pesos 3.73 for the U. S. dollar, applicable to government payments and for the import of certain essential commodities;

(ii) a rate of Pesos 4.23 = \$1 (or Pesos 17 = £1). This rate is applied to the import of certain commodities which, if not essential, are considered important and, in addition, to all imports from the neighbouring countries (Bolivia, Brazil, Chile, Paraguay, Peru and Uruguay) and also to the United Kingdom, together with the rest of the sterling area (which, it should be remembered, does not include Canada and Newfoundland); it also forms the basis for clearing arrangements with various countries;

(iii) the so-called "auction rate", applicable to all imports of goods for which exchange at a more favourable rate is not allowed. The auction rate varies according to supply and demand (with intervention of the Banco Central), averaging about Pesos 5 to the U. S. dollar;

(iv) the so-called "corporation rate", being Pesos 4.55 to the U. S. dollar with corresponding rates for other currencies.

A Foreign Trade Promotion Corporation was formed in 1941 as a means of adjusting the rates of exchange, in particular with regard to trade with the United States, so that, instead of the auction rate of about Pesos 5, a new rate of Pesos 4.55 was applied.

Import restrictions have been gradually lifted, exchange at the rate of Pesos 4.55 being granted to importers in respect of an increasing number of articles. The auction rate remains in force only for typical luxury goods, comprising not more than 2 per cent. of all imports (May 1942). The authorities have been able to act more liberally in their import policy, thanks to a marked improvement in the balance of payments, which, according to estimates of the Banco Central, closed with a surplus of Pesos 472 million in 1941, compared with a deficit of Pesos 65 million in the previous year. A special problem has been created, however, by considerable blocked sterling balances in London, which at the end of 1941 could be utilised only to a limited extent for the redemption of British-held Argentine bonds. In December 1940 it was announced in Washington that the U.S. Treasury Department intended to allocate $50 million from the Stabilization Fund to support the quotation of the Argentine currency in relation to the dollar, and in the same month it was also announced that further exchange assistance would be granted to the Argentine through the Export-Import Bank to the extent of $60 million; owing to the improvement in the balance of payments the Argentine has not been obliged to avail itself of these credits, the agreements remaining unratified.

In Uruguay, the exchange value of the currency continued to strengthen and for some time in December 1941 the dollar dropped in the free market to the level of the official selling rate, i.e. Pesos 1.90, the lowest rate quoted for free dollars for many years. The system of controlled and free rates is maintained largely in order to enable the authorities to encourage exports of certain products by allowing sale of exchange at the free rate, while exchange from the country's principal exports, such as wool and meat, is converted at the controlled buying rate of Pesos 1.519.

Increased exports of nitrate from Chile to the United States, absorbing 85 per cent. of the country's nitrate production, have permitted exchange rates to be kept stable throughout the year, while in Peru there has been some slight variation (within less than 3 per cent.) in the quotation of the dollar. Increased exports of tungsten to the United States have greatly aided the exchange position in Bolivia, where market rates have come close to the official rate, the latter having been altered in June 1941 from Bolivianos 40 to 46 against the U.S. dollar to attain a better correspondence with actual conditions on the exchange market. In Venezuela also, an adjustment was made in the official rate (i. e. the controlled selling rate against the dollar), which was fixed in August 1941 at Bolivares 3.35 against the previous rate of Bolivares 3.19. Dollars originating from petroleum exports continued to be bought by the authorities at Bs.3.09, from coffee exports at Bs.4.60 and from cocoa and cattle shipments at Bs.4.30. Since the Control is a seller of dollars at Bs.3.35, this involves a loss, which takes the place of the previous export subsidy. Exchange obtained from uncontrolled exports and other sources may be negotiated on the free market, where the rate has strengthened in the course of the year. Under the influence of an improvement in the trade balance from a deficit of Contos 3,000 in 1940 to a surplus of Contos 1,215,000 in 1941, the Brazilian currency remained firm all through 1941, no change being made in the official dollar rate while the free rate improved towards the end of the year. In Cuba also, increased exports to the United States — in particular of sugar — together with loans obtained from the Export-Import Bank have strengthened the exchange position, the rate of the silver peso, which in 1940 had fallen to the equivalent of 91 U.S. cents, being brought back to its pre-war value of around 100 cents by the end of 1941.

The Mexican peso, which had been pegged at the rate of Pesos 4.85 to the U.S. dollar in the autumn of 1940, was maintained at about that rate all through 1941 in spite of a certain weakening of the trade balance in comparison with the previous year. On 19th November 1941 an agreement was concluded between Mexico and the United States, providing for the stabilisation of the Mexican peso, purchases of Mexican silver by the United States and extensive Mexican road-building with the financial assistance of the United States. In exchange, Mexico agreed to pay $37 million over a period of fourteen years to settle outstanding property claims of American nationals (other than claims arising from the expropriation of petroleum properties), to make a trade agreement and to attempt to negotiate a settlement of the petroleum controversy. By a subsidiary agreement of the same date, signed by the Secretary of the U.S. Treasury Department and the Mexican Finance Secretary, the U.S. Treasury agreed to spend, from the Stabilization Fund, $40 million to support the Mexican peso. The Treasury also agreed to buy each month six million ounces of newly-mined Mexican silver at 35 cents an ounce from the Bank of Mexico (making a total of $25.2 million a year). The rate at which the peso is to be stabilised has not been disclosed but the rate of Pesos 4.85 has been maintained unchanged by the authorities.

After steps had been taken in the United States to freeze the assets of occupied and certain other countries, a number of Latin American countries adopted similar measures. In the Argentine, for instance, the central bank exercises control over payments to and by countries whose assets have thus been made subject to special regulations, granting, however, certain alleviations in the transfer of funds for specifically defined groups of transactions.

Before the extension of the war to the Far East during the last month of 1941, two currency changes of some importance occurred in that part of the world. In Japan, as from 1st June 1941, the yen was stabilised in relation to sterling at a rate of 1s.2d. = Yen 1 (instead of a rate corresponding to the existing relation with the U.S. dollar). All Japanese forward transactions in English, Egyptian, South African, Australian and New Zealand pounds, Indian rupees, Shanghai and Hong Kong dollars and Thailand bahts were directed through a collective account with the Yokohama Specie Bank and settled at the rate of 1s.2d. Any losses resulting from transactions over this account were covered by a government guarantee of Yen 500 million, any profits arising being credited to the government.

The Shanghai foreign exchange market, which had remained free from all official restrictions up to the summer of 1941, was greatly affected by the measure taken on 25th July 1941 in the United States to freeze dollar assets belonging to Japan and China. (To make freezing of Japanese assets effective, it was necessary to extend the freezing also to Chinese assets since otherwise transactions on Japanese account could have been carried out via Shanghai, occupied by Japan.) Freezing of sterling assets was at the same time imposed by the British Government. To deal with the situation which thus arose, the Chinese Currency Stabilisation Board, the formation of which had been announced earlier in the year, began to operate on 18th August on the Shanghai market, selling a certain amount of sterling for permitted transactions at the rate of $3\,^{3}/_{16}$ d. for the Shanghai dollar (which is also called the Chungking yuan). The consequence was, however, that in the open market other more depressed rates were quoted for the Chungking yuan. To bring order into the situation, it was announced in September that fourteen Chinese, British and American banks had been licensed to deal in foreign exchange under the recent freezing orders and that these banks had undertaken not to deal in the open market in return for a guaranteed source of exchange for approved imports, the Stabilisation Board being ready to sell limited amounts of foreign exchange on a quota basis for a specified number of legitimate imports. The character of the Chinese market was, however, profoundly altered by the appearance of two sets of rates — one official, for a limited number of merchants and transactions, and one obtainable in the open market, offering some advantage for compensation business and similar transactions. Later in the autumn a payments agreement concluded between the United Kingdom and China imposed a kind of Chinese exchange control peculiar in that it was applied from countries other than the domicile of the currency, i. e. from centres outside China. As a result of these arrangements, the exchange value of the Chungking yuan improved in the open market during the latter half of November 1941.

The outbreak of war in the Pacific, as a result of which the United States and the United Kingdom became the allies of China, led to increased monetary assistance to the Chungking Government, which received a credit of $500 million at the beginning of 1942 from the U.S. Stabilization Fund and another credit of £50 million from the United Kingdom. American, British and Chungking banks in Shanghai being closed by the Japanese military authorities, the foreign exchange problem of the Chungking Government was radically altered. In February 1942 this government decided to free the monetary circulation, lifting the restrictions on the movements of legal tender inside the country and on the export of national currency abroad, with the exception of newly-printed banknotes shipped by banks to the port of entry or into the interior, for which shipments a permit from the Ministry of Finance was required.

When the Central Reserve Bank in Nanking opened on 6th January 1941, its currency (the so-called Nanking yuan) was given the same value as the Chungking yuan. Shortly after the outbreak of the war in the Pacific, Japanese banks fixed an exchange rate of Chungking or Nanking Yuan 4 to Military Yen 1 (the currency issued by the Japanese military authorities). The closing of American, British and Chungking banks in Shanghai had, however, the effect of depressing the value of the Chungking yuan and some specific measures were taken with the same end in view. At first, the Nanking yuan was quoted with a premium of 5 per cent. On 7th March 1942 the rate of the Nanking yuan in relation to the military yen was fixed at 5 : 1 (a rate which was purposely not applied to the Chungking yuan); in that way the Nanking yuan became practically a member of the yen bloc. On 23rd March the Nanking Reserve Bank discontinued the exchange of Chungking yuan at par and the official exchange offices fixed a rate of Chungking Yuan 100 = Nanking Yuan 77, while on 30th March the Nanking Government officially announced the abolition of the link between the Nanking and the Chungking yuan. Among the public, however, the Chungking yuan continued to circulate and, in order to maintain the rate quoted by the official exchange offices, the Nanking Reserve Bank was at times obliged to sell Chungking yuan against its own currency. Then, by a new decree of the Nanking Government dated 31st May, provision was made for the withdrawal in certain specified provinces (including Shanghai) of the Chungking yuan, which will be converted into Nanking yuan at the rate of 2 : 1; the conversion into Nanking yuan of debts and bonds based on the old legal tender will also be made at the rate of 2 : 1. Normally notes expressed in the Nanking yuan will be given in exchange for Chungking yuan notes; deposits of banks and financial institutions will be repayable one-half in cash and one-half in government bonds.

On 29th December 1941 a decree was issued in Tokio simplifying Japanese foreign exchange control and restoring the independence of the yen from the Anglo-Saxon currencies. Under the new decree Japanese exchange rates are fixed by the Minister of Finance, who can, however, delegate his power in exceptional cases. Commenting on the new measure, the Minister of Finance declared that the Far Eastern conflict had brought about fundamental changes in Japanese foreign exchange policy, the first step being the abolition of the method hitherto employed for fixing exchange rates on the basis of the sterling and dollar quotations. In future, foreign exchange rates would be fixed autonomously on the basis of the yen currency. As a matter of fact, no essential alteration was made in the range of existing exchange rates. For the Reichsmark a rate of RM 170.50 = Yen 100 was fixed and for the Swiss franc a rate of Sw.fcs 98.90 = Yen 100. On the basis of these rates the exchange rates for the dollar and sterling (currencies no longer quoted in Japan) would be $23.44 = Yen 100 and 1s.2d. = Yen 1, i. e. the same as the rates previously quoted. Of greater importance than the fixing of the exchange rates is the fact that, in future, settlements with countries outside the yen area but still trading with Japan will no longer be made by payments in dollars and sterling. The distinction between "foreign exchange countries" and "yen bloc countries" will thus disappear, settlements being made more and more through clearings and transfers of yen balances. Fixing the value of the yen independently of the Anglo-Saxon countries has not involved any change in the policy with regard to gold. Replying at the end of January 1942 to a question in Parliament regarding Japanese gold production policy during the period of interruption in the foreign trade with third countries, the Ministry of Industry declared that the government would attach the same importance to gold in the future as in the past. Gold would still be necessary for trade between the Far Eastern area and other zones. Moreover, the metal was gaining in importance as an instrument for maintaining and strengthening the credit of the yen currency in the "co-prosperity sphere". The government would continue to protect the gold mining companies with a view to ensuring the gold output of Yen 200 million in Japan and Korea (say, 1.7 million ounces). Asked about the gold value of the yen, a spokesman of the Ministry of Finance declared that under the new régime the price of gold would be fixed by the Minister of Finance.

The military yen (called "gumpyo" in Japanese) was first issued in China in various denominations expressed in yen. In other areas the gumpyo has been issued in the currency of the occupied country — in the Philippines, a military peso, in the Dutch East Indies, a military guilder, etc. In such cases the gumpyo was at par with the local currency but varied in value in relation to the Japanese yen. In the Philippines, the U.S. dollar continued to be taken at the rate of Pesos (or Gumpyo) 2. In April 1942 the Japanese Minister of Finance declared that the currencies circulating in the Philippines (the peso, the dollar and the gumpyo) as well as the currencies circulating in the Dutch East Indies (the guilder and the gumpyo) would all be replaced by notes issued by banks and similar institutions.

In Hong Kong the value of the silver dollar was fixed, in relation to the military yen, at 2 to 1. The Chungking and British Governments have taken certain measures to enable Chinese holders to exchange Hong Kong dollars at the old rate of Chungking Yuan 4.65 = Hong Kong $1.

In relation to Indo-China a special exchange rate has been fixed at Yen 97.60 = Piastre 100 instead of Yen $98^1/_8$ before Japan's entry into the war.

In Thailand, the baht was defined in February 1942 as equal to 0.32639 grammes of fine gold (instead of being linked to sterling at a rate of Baht 11 as previously). The rate in relation to the Japanese yen was adjusted accordingly, being fixed at Baht 100 = Yen 155.10 instead of Yen 125.25 as was previously the case. But in April 1942 the relationship between the two currencies was altered to Baht 1 = Yen 1.

There has been a considerable expansion in the issues not only of the Chungking yuan but also of the yen currencies. For the whole yen bloc the note circulation at the end of 1941 is reported to have been Yen (or Yuan)

10.17 milliard, compared with 3.5 milliard at the end of 1937. In Japan itself the circulation rose from Yen 2.16 milliard at the end of 1937 to 6.23 milliard at the end of 1941, i. e. in very much the same proportion as the increase for the area as a whole.

One other country in Asia has altered the exchange value of its currency in the year under review, namely Iran. Up to the autumn of 1941 there was a basic rate of Rials 68½ plus a premium of Rials 105½, making altogether Rials 174 for the pound sterling. In recent years the Iranian Government has accumulated considerable reserves of sterling, which have been protected by rigid exchange restrictions. Expenditure of the British forces in the country has led to a further increase in the holdings of sterling; and in September 1941 the exchange rates were altered from Rials 174 to 140 = £1 and from Rials 45 to 35 = $1. Measures were also contemplated for the relaxation of exchange restrictions. The currency is pegged to sterling but technically Iran is not a member of the sterling area.

In the year under review there has been a certain consolidation within each of the large currency areas into which — with few exceptions — the world has become divided. Signs of this consolidation are: a greater consistency of rates and cross rates on the continent of Europe as between the Reichsmark and the so-called free currencies; maintenance of free transfers within the sterling area; the granting of stabilisation and other credits by the United States in aid of currencies closely linked to the dollar, and exemption of all countries in the western hemisphere from the freezing of foreign assets; the extension of the yen bloc, together with increased settlements in yen balances (and no longer in dollars and sterling) within the area dominated by Japan. Another large area of the world is served by the rouble of the U. S. S. R. The separation between the different currency areas is made more distinct by the obstacles to trade resulting from the war: there is little interchange of goods between the different groups other than the sterling area and the dollar countries, between which exchange stability has been maintained through the pegging of the sterling-dollar rate.

The coherence of monetary conditions within each area must not, however, be exaggerated for, even if exchange rates are kept stable through clearings, special accounts, monetary credits and in other ways, each currency has still, as a rule, its own individuality, with its own credit structure and volume of means of payment. The internal value (the purchasing power) of each separate currency is liable to change under the influence of reduced supplies of goods and an increased supply of money — in some countries more, in others less, according to the strength of the forces at work, the efficiency of price control, etc. As a result of such changes, it is inevitable that now and then the exchange rates, kept stable by the control, get out of line with the true value of the respective currencies. While the war lasts there is an evident disinclination to make corrections which would involve reductions in exchange value: each government, fighting inflation, is anxious to avoid any alterations which could be interpreted as signs of an avowed depreciation of its currency. In fact, the tendency is to move in the opposite direction: to appreciate the currency. The contradiction between fixed exchange rates and often rapidly shifting basic conditions may be disguised for the time being by control measures, credits and other expedients, but it undoubtedly gives rise to problems which sooner or later will cry out for solution. In this respect it will make little difference whether the particular countries apply extensive government intervention or restore a greater measure of freedom to their economies, since in any case a correspondence must ultimately be attained between the external and internal value of the various currencies. To the process of readjustment, all countries — large and small — will have to make their contribution in one form or another, in order to re-establish a structure of appropriate exchange rates for the future.

It is often said — and with considerable justification — that the level of costs, and particularly of wages, should be accepted as the best indication of the real exchange value of a currency. In a modern economy the amount paid out as wages generally represents one-half — sometimes even more — of the total national income and is thus the main element in the volume of buying power in the hands of the public. In addition, there is a growing inflexibility of wages, now more than ever fixed by trade union agreements and other regulations. Before 1914 it could probably still be taken for granted that in most countries wages would move fairly rapidly in response to a change in business conditions; if the trend of affairs went against a country and the discount rate had to be increased, the reaction on the labour market was likely to be in the direction of a downward adjustment of wages. No similar response to alterations in the discount rate can be expected at present and its effectiveness as a means of restoring monetary equilibrium has thus been in a large measure impaired.

A growing understanding of the insufficiency of some of the older methods of ensuring a monetary balance has sometimes led to the conclusion that the only way of preventing a perpetuation of monetary disequilibria on foreign account is to admit relatively frequent adjustments in exchange rates. The striving for exchange stability, as known in the past, would thus be replaced by a policy of flexible rates. There will in all probability be cases of major maladjustments in which the correction will have to be made by a depreciation of the currency; reductions of wages by anything like 20 or 30 per cent. might well expose the social fabric to too great a strain and too heavily increase the burden of public and private indebtedness.

Should the same view be taken of maladjustments which would demand a reduction of costs by, say, only 10 per cent.? Such maladjustments may, indeed, also have most pernicious effects: they may be the cause of much unemployment, lead to a drain in the balance of payments and provoke the introduction of protective measures interfering with the currents of trade. As long as business is booming in the world generally, the unbalanced position of a particular country may not seem a serious handicap; the test comes in the strain of a general depression. For these reasons it is important that relatively limited maladjustments should also be speedily and effectively corrected; but should the correction be made through an alteration in exchange rates or through cost adjustments?

Perhaps no general rule can be laid down; there are arguments on both sides and much depends upon what is feasible in any particular country. Alterations in rates of exchange are undoubtedly disturbing to confidence at home and cause irritation abroad. Either the buyer or the seller of capital goods, for which payments are usually spread over a number of years, would have to face uncertainty as to the price in his own currency whenever there was a prospect of varying exchange rates. (In practice the possibilities of covering forward amounts due under such long-term contracts are very limited.) The investment trades — so important in the business cycle — would thus be particularly handicapped in their international activities. Moreover, a unilateral exchange policy, if it were pursued with little regard to the interests of other countries, would undoubtedly provoke measures of retaliation harmful in their effects not only to the country which altered the exchange value of its currency but to the development of world trade generally. A particular country which adopts a policy of flexible exchange rates is likely to find that — apart from exceptional circumstances, such as the present war period — the tendency will nearly always be to lower but hardly ever to raise the exchange value of the currency; depreciation may provide what appears to be an easy way out of temporary difficulties but has the disadvantage that it does not subject the various branches of the economic life to a process of rationalisation, which may be painful but which in the end leads to an increase in the volume of production and thus in the standard of living.

From many points of view it would be preferable if, in the event of a minor maladjustment, the necessary correction could be made by an adaptation of costs. But monetary authorities alone have no longer the means to give effect to a policy of cost adjustments. To be successful they must be assisted by direct action on the part of the main economic groups in the country, including the labour organisations. Cooperation of labour or resistance by labour may make all the difference with regard to the monetary policy that can be pursued. Nowadays, labour representatives often demand that they should have an opportunity to participate in the formation of monetary policy. These demands may be regarded as part of a general tendency to associate persons having an intimate knowledge of various economic branches (and not only of financial affairs) with the direction of monetary policy. It is, however, recognised that persons thus brought in must not regard themselves as representatives of particular interests; having been appointed members of a monetary authority, they must help to frame the best policy from a general point of view. That being so, occasions may arise on which they will have to face and press for at least temporary sacrifices by the groups with which they are in special contact.

The complexity of organised interests in a modern society makes it harder in some ways to apply a sound monetary policy; that does not mean that the problems are insoluble but merely that new forms of securing adjustment must be found. Undoubtedly, the attitude of labour plays an increasingly important part in determining the lines of policy which can be successfully pursued; and, as always, greater power involves greater responsibility.

2. FOREIGN TRADE.

Foreign trade is one of the fields of economic activity in which the suppression of current statistical information has been most pronounced. Once interception of the enemy's commerce has become the main weapon of economic warfare, secrecy will obviously be observed with regard to the magnitude, composition and direction of foreign trade. Among the great powers, Germany, France, Italy, Japan, the United Kingdom and the U. S. S. R. do not publish any foreign-trade returns, and in the autumn of 1941 the United States discontinued the publication of all but the global figures of its trade balance. Among other countries, Albania, Belgium, Greece, Holland, Norway, the Governor-Generalship of Poland, the Protectorate of Bohemia and Moravia, Roumania and Turkey have one after the other stopped the publication of foreign-trade data; and in most of the remaining countries, especially in Europe, only the principal figures of the trade returns are made public. Moreover, general indications of the main tendencies of foreign trade, given in speeches or reports of a more or less official character, have become scarcer and less definite.

Where data are available, comparisons of current figures with those of previous years can be made only with great caution, partly because deliveries of arms and ammunition, ships, etc. may be excluded from the returns without notice, partly because of the continuous rise in prices since the war began. In general, import prices have risen more sharply than export prices. This is largely due to an enormous increase in transport costs together with the fact that the import prices used for the computation of import values or price indexes are, almost without exception, c. i. f. prices, while the export prices are calculated on a f. o. b. basis. A striking example of the increase which may be caused by transport charges is provided by the import of oats from the Argentine to Switzerland: while in May 1942 the f. o. b. price of 100 kilogrammes of oats in the Argentine was the equivalent of Sw.fcs. 7.85, the cost of transport from the Argentine to Switzerland amounted to Sw.fcs. 50.35, so that the price at the Swiss frontier came to Sw.fcs. 58.20.

The prolongation of hostilities has everywhere intensified the need of materials and finished products not procurable in sufficient quantities within the national boundaries. Peacetime considerations regarding the maintenance of a balanced trade, the furthering of exports and so on have given way to more urgent needs. In each camp the members have concluded with one another, or with neutral countries, agreements which, though different in form, are identical in essence and purpose, financial considerations being subordinated to the maintenance of supplies. New technical arrangements have been developed in order to ensure a smooth working of financial settlements and to prevent, within certain limits, a lack of foreign resources from hindering the even flow of goods. In the first quarterly report to Congress, the President of the United States, speaking about the Lend-Lease Act, pointed out that "... unlike prior methods it focuses directly on the aid to be rendered rather than upon the dollar sign ultimately to be translated into war materials." Likewise, by an agreement signed at the end of February 1941, Germany and and Italy decided that during the war any furnishing of war material between the two countries should be carried on without regard either to the balance of trade or to the situation of the clearing account. Similarly, the German-Finnish trade and payments agreement for 1942 provides that deliveries shall take place regardless of the trade balance, which in practice will mean the granting by Germany of long-term credits to Finland. In addition to these agreements of a more fundamental character, there is a whole series of arrangements providing facilities in various forms (advances on clearing accounts, export credit guarantees, etc.) to fill the gap between actual deliveries and payments by the foreign purchaser. Financial assistance between belligerent countries is, of course, arranged for the purpose of winning the war, while neutral countries as a rule seek to obtain, as a counterpart to the credits they may grant, deliveries of materials badly needed to keep their industries working and transport facilities for their foreign trade.

Closely connected with the various credit arrangements of the belligerent powers, there has been a gradual transformation in foreign-trade policy from the peacetime preoccupation with export markets to wartime insistence on the greatest possible supply of goods from abroad. This change in emphasis is particularly noticeable in the policy of the United Kingdom. The depreciation of sterling by 14 per cent. in the autumn of 1939, and still more the further fall of "free sterling", acted as a stimulus to exports but was bound to have, at least to some extent, the opposite effect on the volume of imports. Under government leadership the British export trade was organised on a large scale at the beginning of 1940 so as to yield its utmost, in order to provide currencies for the payment of essential imports. At first, exports were directed to all countries not cut off by the war, but this indiscriminate export drive was soon replaced by a new policy of selective exporting devised to obtain dollars and other "hard" currencies; a reduction in the volume of exportable goods as the British war effort gained momentum made it necessary to concentrate on those countries where means of payment were most urgently needed. Then in March 1941 came the approval of the lend-lease programme by U. S. Congress, through which the drive for increased exports lost much of its incentive, the United Kingdom being able to obtain American goods irrespective of the means of payment available. In a memorandum delivered to the American Ambassador in London in September 1941 on the British Government's policy "with regard to exports from this country [the United

Kingdom] and the distribution here of lend-lease material", it was stated that "the United Kingdom's export trade is restricted to the irreducible minimum necessary to supply or obtain materials essential to the war effort". The British Government most specifically gave an undertaking that all materials "similar to those supplied under lend-lease" should not be applied "in such a way as to enable [British] exporters to enter new markets or to extend their export trade at the expense of United States exporters". Apart from the increased call on domestic production for defence needs, it appears that one of the main reasons which dictated the new course in the British foreign-trade policy was the avowed intention of ensuring that British exporters should not avail themselves of the lend-lease facilities to supply goods to markets outside the Empire on better terms than their American competitors. Only a few exceptions were admitted on clearly specified conditions. Thus, during 1941 British foreign-trade policy underwent a fundamental change, shifting over from an effort to maximise exports to a concentration on the minimum needed.

A certain degree of similarity with these developments in the United Kingdom is found in Germany, although the circumstances of the two countries differed in many respects. In the autumn of 1939 Germany had ready or in process of production goods of various kinds which, had there been no war, would have been exported to France, Great Britain and extra-European countries; in the new situation these goods were largely sold to countries in Europe with which trade relations were maintained. The result was that during the first months of the war Germany had an active foreign-trade balance, which was used to repay clearing debts and in some cases to build up resources in foreign currencies. For some time Germany maintained the system of export premiums introduced in the 'thirties to enable her exporters to compete on foreign markets notwithstanding the high exchange value of the Reichsmark. The predominant position which Germany acquired on the continent of Europe with the disappearance of Anglo-Saxon and other outside competition made it possible, however, gradually to abolish the export premiums and, as the need arose, Germany began increasingly to draw on clearing accounts and to avail herself of other facilities to pay for imports. There was a reversal in the trend of the German trade balance, reflected in an accumulation of Reichsmark assets by Germany's clearing partners. Thus, here also, the initial export drive was changed into the minimum needed to satisfy the most essential requirements of the countries which provided the bulk of Germany's imports.

The change in trade policy imposed by the strain of the war has not been limited to the United Kingdom and Germany but has gradually affected other countries also, the main problem everywhere being how to secure sufficient imports. Steps are taken to reduce (or suspend) import duties, to grant import subsidies, to appreciate currencies or to allocate foreign exchange at preferential rates for the purchase of essential goods from abroad. While during the depression which began in 1929 countries vied with each other in imposing new restrictions on imports and finding new means of stimulating exports, they now apply their ingenuity to the invention of measures designed to favour imports, reserving their internal supplies as far as possible for their own needs. They even tend to be less concerned about the maintenance of employment in their export trades, having discovered that under war conditions diminished employment in a few branches can as a rule be overcome without great difficulty by shifting workers to other occupations (e. g. substitute industries) where the demand for labour has risen.

It is becoming more and more difficult to speak about "world trade". The extension of the war in the Pacific, the declaration of hostilities between the Axis powers and the United States, and stricter application of blockade and anti-blockade measures have accentuated the tendency to watertight compartments, where the trickle of trade still allowed through the blocked areas to and from the few neutral countries in Europe serves barely as a reminder of what was once peacetime commerce. The dependence of Latin America on the United States, the development of the Far Eastern area under the influence of Japan, and the closer relations between countries on the continent of Europe are features which have gained in importance, while the ties between distant parts of the world are maintained, albeit with increasing difficulty, by members of the British Empire and the United States.

An idea of the increased importance of **Germany** in the trade turnover of almost all countries on the continent of Europe may be gauged from the following table.

Percentage of Trade with Germany in Total Turnover.(1)

Percentage of total trade of:	1938	1941
Bulgaria	59 (2)	80 (2)
Denmark	22	80
Finland	17	55
Holland	19	62 (3)
Hungary	29	59
Italy	23	over 50
Norway	17	63
Roumania	31	65 (4)
Slovakia	—	36
Spain	27	22 (3)
Sweden	21	48
Turkey	45	20 (5)

(1) In the sources from which the percentages for 1941 have been taken, there is as a rule no indication whether or not *these percentages* include trade with the Protectorate of Bohemia and Moravia.

(2) Exports only. (3) May 1940–February 1941.

(4) January–June. (5) January–May.

The only recent indication concerning Germany's foreign trade is to be found in a speech by a Director of the German Reichsbank, who stated that by the end of 1941 the volume of German foreign trade, after the decline suffered upon the outbreak of hostilities, had again attained 80 per cent. of the pre-war level, while in value this level had been greatly surpassed. Practically all Germany's trade is now with countries on the continent of Europe. Prior to 1939, Europe, with the exclusion of the British Isles and the U. S. S. R., absorbed nearly 60 per cent. of Germany's exports and supplied around 50 per cent. of its imports, thus leaving an export surplus in favour of Germany at the rate of RM 600 to 900 million. As can be judged from the evolution of the clearing accounts, Germany has now on balance an import surplus vis-à-vis the rest of Europe.

The last global figures disclosed with regard to **Italy's** foreign trade refer to 1940; for 1941 it was officially stated that exports exceeded imports.

In 1938 Italian trade with countries outside the continent of Europe amounted to over 40 per cent. of the total; after a short-lived intensification up to the summer of 1940, this trade rapidly declined and, in the course of 1941, must have reached a complete standstill. With regard to Continental Europe, towards which Italian trade is now almost exclusively directed, as against 50–60 per cent. in 1938, the situation early in 1942 was summed up as follows: there is a group of countries with which Italy can hardly be said to have any regular trade relations (Greece and Serbia); with a second group (including, among others, Portugal), after a temporary reduction, there is a tendency to return to the previous level; with a third group (Bulgaria, Denmark, Finland, Hungary, Roumania, Slovakia, Spain and Sweden) a more or less noticeable increase has been, or is likely to be, attained. Finally, there is a fourth group, in relation to which trade is influenced by special conditions; it includes Croatia, France, Switzerland, countries occupied by Germany and, above all, Germany itself.

Already before the war Germany occupied a primary position in Italian external trade, absorbing, during the five years to 1938, on an average, around one-fifth of Italy's exports and supplying about one-fourth of its imports, with an export surplus varying between Lit. 0.5 and 1.4 milliard in favour of Germany. In 1938 Italian exports and imports from Germany (including Austria) reached respectively Lit. 2 and 3 milliard, or about 23 per cent. of Italy's total trade turnover (Lit. 21.8 milliard). According to semi-official declarations, trade between the two countries in 1941, in each direction, reached, or even exceeded, RM 1 milliard, a total of at least RM 2 milliard, or Lit. 15 milliard at the official rate of exchange, equivalent to about two-thirds of Italy's total foreign trade in 1938. This represents an increase of more than 300 per cent. in the value of Italo-German trade, being in part the result of an increase in volume and of the extension of German territory since 1938, but also a reflection of higher prices. With regard to the trade balance, it seems that German deliveries during 1941 were some 10–15 per cent. higher than those of Italy but this discrepancy appears to have been partly balanced by remittances of Italian workers in Germany, estimated at around RM 360 million a year.

At the beginning of 1942, after a period of interruption, Hungary resumed the publication of figures showing the direction of the country's foreign trade (but not the quantitative distribution of the different commodities). For the year 1941 the value of exports rose by 54 per cent. and that of imports by 21 per cent. in comparison with 1940, leaving an export surplus of Pengö 61 million against a passive balance of Pengö 88 million in the previous year. This development was all the more significant since in 1941 crops were still very poor, though slightly better than in 1940. Apart from the influence of territorial gains, amounting to about 54,000 square kilometres (43,500 in 1940 and 10,500 in 1941), the increase in the export value during 1941 was primarily due to a rise in the prices of agricultural products fostered by government measures, by which the discrepancy between import and export prices was appreciably reduced. *About nine-tenths of the foreign trade passes through clearings.* The share of Germany and Italy has increased roughly from 60 to 80 per cent. on the import side and from 65 to 75 per cent. on the export side. Hungary's trade balance with Germany has become active, the surplus rising in the first quarter of 1942.

Unlike developments in Hungary, the export surplus of Slovakia, which had amounted to Ks. 303 million in 1940, turned into an import surplus of Ks. 309 million in 1941. Imports rose in value by 21 per cent., while exports remained practically at the same level. In spite of larger imports from Germany, the clearing claims on that country nearly doubled during 1941, reaching Ks. 2 milliard by the end of the year as a result of higher amounts transferred by Slovak workers in Germany. In order to neutralise a rise in the price of imports from Hungary, prices of Slovak exports were increased by 17 per cent. under an agreement between the two countries, the proceeds of this increase being credited to a special fund with the Slovak National Bank, from which subsidies were to be granted to importers of Hungarian goods.

While in 1940 the trade balance of Bulgaria was practically in equilibrium, with an import surplus of Leva 9 million only, the excess of imports over exports rose in 1941 to Leva 1,005 million. Both imports and exports increased in value. Imports rose in volume also (from 383,000 tons in 1940 to 459,000 tons in 1941), while the volume of exports fell by over 50 per cent. (from 996,000 tons in 1940 to 460,000 tons in 1941). The increase in imports is mainly the result of larger supplies for the army and of investment goods (partly machinery). The fall in the export volume is due in the main to a change in the composition of the trade: unfavourable cereal crops as well as transportation difficulties led to the export of goods of higher value but less bulk: exports of wheat, beans, vegetables and fruit were greatly reduced; the export of tobacco, which in normal years represents 40 per cent. of the country's total exports, rose in 1941 to a record level, while dried products, jams and fruit juices were exported instead of fresh fruit and vegetables. The increased import surplus did not cause a reduction in the foreign exchange balances of the National Bank, the reason being that payments for investment goods imported mostly from Germany are as a rule to be spread over a number of years. The rise in commodity prices in Bulgaria, from an index figure of 97 in December 1940 to 124 in December 1941 (1926 = 100), affected export values; in negotiations with Germany and other trade partners, stress has been laid upon the importance of maintaining stable prices for goods entering foreign trade.

Loss of territory to the U. S. S. R., Hungary and Bulgaria, as well as unfavourable crops, reduced Roumania's wheat production from 48.2 million quintals in 1938–39 to 13.7 million in 1940–41, a reduction of over 70 per cent., which, together with other reasons (mobilisation and actual warfare), led to a shrinkage of about two-thirds in the export of Roumania's cereals (from 12.5 million quintals in 1940 to 3.4 million — mostly maize and peas —

in 1941). Nevertheless, a reduction of about one-third in the value of imports, as well as price increases in some of the most important exports products, made the trade balance show an export surplus of Lei 6.7 milliard in the first half of 1941, compared with Lei 5.4 milliard in the same period of the previous year. Exports of oil and oil products contributed 72 per cent. of the total export value in the first half of 1941 against 55 per cent. in the corresponding period of the previous year. Roumania's oil output is reported to have fallen by 40 per cent. since the peak year 1936, when it amounted to 8.7 million tons; but reduction in export quantities has been more than counterbalanced by increased prices and steps have been taken again to augment production. Germany takes first place in Roumania's foreign trade, absorbing about 65 per cent. of exports; Italy comes second with about 11 per cent. and Switzerland third with 6 per cent. (on the basis of figures for the first half of 1941).

Some figures have been disclosed concerning the foreign trade of Greece during 1941: exports amounted to Dr. 3,904 million and imports to Dr. 4,840 million as against Dr. 10,149 million and Dr. 14,761 million respectively in 1938, a contraction of no less than 60 per cent., surpassed, however, by the shrinkage in volume, which was over 80 per cent. It is pointed out that it is difficult to speak of foreign trade in the real sense of the word; during the first quarter of 1941 imports consisted mostly of war deliveries from the British Empire, the U. S. A. and the U. S. S. R., while in the following period the greater part of the goods received came from Germany, Italy, and later also from Turkey in the form of "aid to the Greek people". Exports were limited by the increasing transport difficulties, and by the necessity of retaining the major part of home-produced goods for domestic consumption.

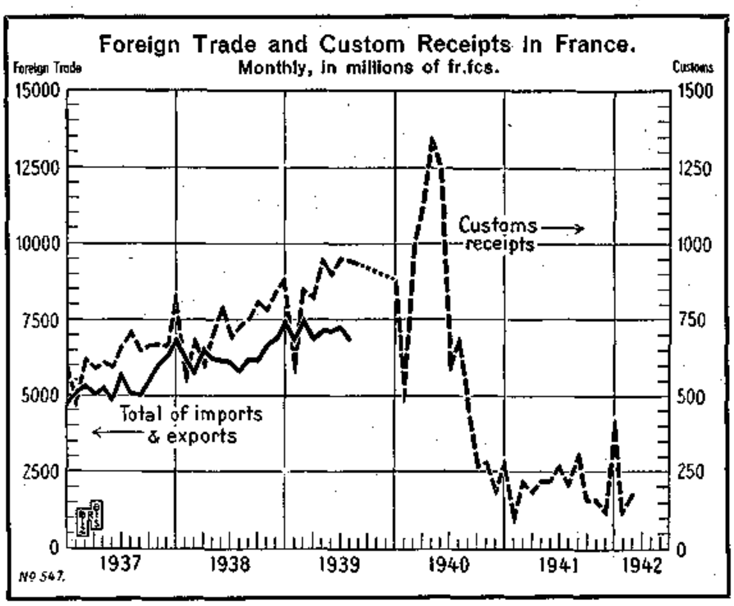
For the trade of other countries in south-eastern Europe — Albania, Croatia, Montenegro and Serbia — no statistical information is available. Commercial negotiations have been opened between Croatia and certain neighbouring countries, and arrangements have been made for payments through clearings. The Protectorate of Bohemia and Moravia (in customs union with Germany since October 1940) had an import surplus in 1941 in relation to Hungary and Slovakia, to judge from the trade returns of these two countries.

No official figures have been published with regard to the foreign trade of France since the outbreak of the war in 1939, but some conclusions may be drawn from official data relating to advances in the clearing, and other indications in speeches, etc. Trade with Germany (and some other countries) is settled through the Franco-German clearing, which is kept separate from the account for occupation costs. In so far as imports are insufficient to provide the francs needed for payments to French exporters, amounts are advanced by the French Treasury to the Exchange Office charged with the administration of the clearings.

Under present conditions, the clearing deficit covered by these advances reflects the net export surplus of French foreign trade (except trade with the colonies). This deficit amounted at the end of 1941 to Fr.fcs 12 milliard (according to the annual report of the Bank of France). It corresponds presumably to a somewhat higher export surplus in relation to Germany, since the other clearings show a slight import surplus. Besides Germany, clearings are in operation with the following countries: Belgium, Holland and Norway (which belong to the Franco-German clearing group), and Finland, Italy, Spain and Switzerland, with which separate clearings are in force.

In the opening months of 1942, the deficit in the clearings showed a material increase and appears to have substantially exceeded Fr.fcs 2 milliard a month (instead of a monthly average of Fr.fcs 1 milliard in 1941). The increase is the result of a higher export surplus to Germany.

In relation to countries other than Germany, the French market is, as a rule, unable to furnish sufficient commodities to balance its purchases. The Swiss Chamber of Commerce has reported that French deliveries to Switzerland fell by over 70 per cent. from Sw.fcs 144 million in the first half of 1939 to about Sw.fcs 40 million in the first half of 1941. If account be taken of the rise in prices, the fall in the volume of French exports to Switzerland must have been even greater. This is the second time in rather more than half a century that France has had a passive trade balance with Switzerland; the previous occasion was in the years 1914–19. Trade with the colonies (which is not dealt with on a clearing basis) gave rise to a surplus of imports into France proper, which in 1941 attained about Fr.fcs 9 milliard.



The development of total French foreign trade is reflected in the yield of customs, as shown in the graph.

Several new trade agreements were concluded during 1941 (with Italy, Finland, Norway and Spain). Some overseas trade could still be maintained, though irregularly, in a very limited measure and under special conditions, between French North Africa and the American continent.

No trade statistics are published either for Belgium or for Holland. The clearing transactions of both these countries continued to pass via Berlin and, from the movements of their clearing accounts with Germany, it may be concluded that both countries have export surpluses in relation to Germany. It was announced in July 1942 that, so far, orders amounting to approximately

Foreign Trade
of Norway, Denmark, Finland and Sweden.

In millions of national currency units	Exports		Imports		Trade balance	
	1940	1941	1940	1941	1940	1941
Norway* . . .	442	446	709	888	— 267	— 442
Denmark. . .	1,517	1,277	1,377	1,311	+ 140	— 34
Finland . . .	2,875	4,189	5,180	8,818	—2,305	—4,629
Sweden . . .	1,328	1,351	2,005	1,672	— 677	— 321

* First nine months only.

RM 2,500 million had been placed in Holland by Germany.

The latest figures published of Norway's foreign trade refer to September 1941. If the results of the first nine months of 1941 are compared with those for the corresponding period of the previous year, it will be found that, in value, exports were practically the same, while imports rose by 25 per cent. In relation to the first nine months of 1939, the total turnover (imports plus exports) was, however, down by 11 per cent., while the shrinkage in volume was much more pronounced (the wholesale price index showing a rise of about 70 per cent.). In the composition of exports, forest products have lost but metals (copper and aluminium) have gained in importance. The disappearance of the greater part of the income from shipping (amounting before the war to N.Kr. 450 to 750 million a year) has radically affected the balance of payments. The whole foreign trade passes through clearings; in the spring of 1942 Norway seems to have had a net clearing liability in relation to Germany of about N.Kr. 200 million.

Denmark's foreign trade balance, which in 1940 closed with an export surplus of D.Kr. 140 million, showed an import surplus of D.Kr. 34 million in 1941. Danish imports and exports fell during the year both in value and in volume; if account is taken of the rise in prices, the fall in the volume of exports amounted to about 40 per cent. Denmark suffered in 1941 from a poor harvest (at least 10 per cent. below the average) and from a setback by one-third in the animal production as a result of the cold winter of 1940–41, the prolonged dry weather in the following spring and lack of imported feeding stuffs.

In an agreement between Sweden and Denmark covering the first half of 1942, it was provided that Swedish exports to Denmark should total S.Kr. 52 million, while Denmark as a counterpart would make deliveries to Sweden for an amount of S.Kr. 40 million and to Finland for about S.Kr. 12 million, the latter amount constituting, in fact, a Swedish credit to Finland.

The turnover of Finland's foreign trade increased considerably in 1941, exports rising by 45 per cent. in comparison with the previous year and imports (without war materials) by 70 per cent. In a large measure these increases were due to higher prices but it is reported that, in volume, exports were 10 and imports 30 per cent. higher than in the previous year. The import surplus increased from FM 2.3 milliard in 1940 to FM 4.6 milliard in 1941, totalling FM 6.9 milliard for the two years, compared with an export surplus of FM 7.3 milliard in the ten years from 1930 to 1939 (which, together with surpluses on other items in the balance of payments, in particular income from shipping, had made it possible to repay almost in full the country's foreign indebtedness). According to a report by the bank controller, the Finnish balance of payments closed in 1941 with an adverse balance of FM 3.5 milliard, covered to the extent of FM 3 milliard by an increase in foreign indebtedness. As shown by the returns of the Bank of Finland, the passive balance on clearing accounts rose from FM 26 million at the end of 1939 to FM 338 million at the end of the following year and FM 1,490 million at the end of 1941. Trade with Sweden is not governed by clearing, but commercial arrangements have been concluded under which certain credits have been granted to cover surplus exports from Sweden to Finland.

In value, Swedish exports remained practically the same in 1941 as in 1940 but imports fell by over S.Kr. 300 million, reducing the import surplus from S.Kr. 677 million in 1940 to S.Kr. 321 million in 1941. The Konjunkturinstitut in Stockholm has calculated an index for the volume of imports and exports, according to the average prices in 1936*, as follows.

Volume of Swedish Foreign Trade.

Base: 1936-38 = 100	Imports	Exports
1939 January-November	121	104
1940 „ „	76	57
1941 „ „	47	51

In comparison with the years 1936–38 the volume of foreign trade has fallen by about one-half, imports a little more and exports a little less. Since the continent of Europe (excluding the British Isles and the U. S. S. R.) before 1939 accounted for about 54 per cent. of Swedish imports and exports, it may be concluded that there has been on balance no compensation in Europe for the loss of trade with the Western countries caused by the events in 1940. Of this trade it has been possible, by a system of German "Geleitscheine" and British navicerts, to maintain some exchange of goods via Gothenburg; in 1941 thirty-four ships entered and left Gothenburg, carrying imports for S.Kr. 220 million and exports for S.Kr. 108 million, the total corresponding to about 10 per cent. of the turnover in Swedish foreign trade. (Up to the summer of 1941 it had also been possible to trade for a year via Petsamo in northern Finland. Exports never assumed any proportions worth mentioning but goods were imported by this route to the value of S.Kr. 100 million.) Trade with Germany has increased in importance: in 1941 Germany provided 52 per cent. of all Swedish imports (in 1938: 22 per cent.) and took 41 per cent. of Swedish exports (in 1938: 24 per cent.). Up to the autumn of 1941 Germany had a substantial active balance in the German-Swedish clearing (at times exceeding S.Kr. 200 million). When, however, the clearing, which also comprises settlements of financial claims, turned against Germany, arrangements were made in September 1941 for an advance of S.Kr. 100 million on clearing account and, at the beginning of 1942, as part of a general trade agreement, for guarantees to be given through the Swedish Export Credit Office to Swedish

* A calculation according to the method employed by the Swedish Konjunkturinstitut naturally gives a much better measure of changes in the volume of trade than mere statistics regarding the weight of the goods moved (or the number of loaded wagons crossing the frontier), which are the only indications of volume available for most countries.

exporters in certain specified branches. In accordance with this agreement, exporters will be paid 50 per cent. in cash and the remainder within twelve to eighteen months; the state guarantee covers, in some cases, 35 and, in others, 25 per cent. of the total amount due, so that the exporter must assume as his own risk 15 or 25 per cent. of the value of the goods sold to Germany. S.Kr. 300 million has been provided by the state for the granting of export credit guarantees (which are not limited to trade with Germany). After Germany, Italy has become Sweden's most important trade partner, followed by Norway, the United States, Denmark and Switzerland.

In value, both the imports and the exports of Switzerland rose by 10 per cent. in 1941 in comparison with the previous year, but, quantitatively, imports fell by about 20 per cent., while exports remained practically the same. There was, however, a change in the composition of exports, heavier and bulkier products, particularly machines, having replaced to a great extent other commodities, such as textiles. The relationship between import and export prices moved further to the disadvantage of Switzerland; the average price of all imports rose by about 80 per cent. from 1938 to 1941 (against an increase of 55 to 60 per cent. from 1913 to 1916); it has been calculated that, of the total value of Sw.fcs 2,024 million for imports in 1941, somewhat more than Sw.fcs 900 million represents price increases since 1938. The formation of a mercantile marine has, in spite of its small tonnage (11 vessels with a total tonnage of 39,700*), proved useful in keeping Switzerland in touch with overseas countries. As regards the three neighbouring countries, trade with France, which in 1938 represented a little over 10 per cent. of total Swiss trade, was reduced to a trifling amount, being regulated by the modus vivendi of 1940. In the spring of 1942 the Italian Government gave notice of the termination of all trade agreements concluded with Switzerland since 1935, declaring itself prepared to open negotiations for a new agreement. In an agreement with Germany signed in July 1941, provision was made for the granting of advances by the Swiss Government to exporters to Germany. In view of the growing difficulty in obtaining raw material supplies and the consequent exhaustion of available stocks, Swiss trade with Germany is increasingly assuming the aspect of a finishing trade, while, generally speaking, Switzerland can accept orders only if valuable raw materials are offered in compensation or if the raw material contained in the finished goods is supplied by the country placing the order.

Foreign Trade
of Switzerland, Turkey, Spain and Portugal.

In millions of national currency units	Exports		Imports		Balance	
	1940	1941	1940	1941	1940	1941
Switzerland . (Jan.-Dec.)	1,316	1,463	1,854	2,024	— 538	— 561
Turkey . . . . (Jan.-May)	61	74	34	33	+ 27	+ 41
Spain . . . . (Jan.-Dec.)	394	—	621	—	— 227	—
(Jan.-June)	—	256	—	252	—	+ 4
Portugal . . . (Jan.-Dec.)	1,613	2,896	2,524	2,643	— 911	+ 253

* Including one vessel of 2,750 tons for Red Cross service.

In May 1941 Turkey suspended the publication of her foreign-trade statistics; up to that month exports had risen in value by 21 per cent., chiefly on account of higher prices, while imports had fallen by 3 per cent. It should be remembered that these figures do not reflect the effect of the German-Russian hostilities in the Black Sea, which undoubtedly have had an adverse influence on Turkish trade. During the years before the war Germany had been making considerable gains and, in 1939, was still supplying about 50 per cent. of Turkish imports and absorbing about 37 per cent. of her exports. Italy displaced Germany as Turkey's most important trade partner in 1940, but in 1941 trade with Great Britain assumed increased importance, Turkish imports from this country advancing to the first place. During 1941 Germany again improved its position; in an agreement of October 1941 provision was made for a total turnover, up to the end of March 1943, of RM 400 million (equivalent to about £T 134 million per year, or almost the pre-war value of Turkish-German trade).

The changes undergone by the Spanish export trade since 1931 appear from the following table.

Spain's Export trade.

Commodities	1931	1935	1940	1941
	in percentages			
Live cattle	0.38	0.07	0.14	—
Raw materials	16.8	18.5	31.8	37.7
Food	68.6	64.1	46.5	33.6
Finished products	14.2	17.4	21.6	28.6

From 1931 to 1941 the share of raw materials and finished products in Spanish exports more than doubled, the share of food falling to one-half. While Spain in the past always had an excess of foods exports, it has now become, on balance, an importer of foodstuffs. Wines, sardines, olives and oranges count as the most important export items, together with mineral ores; on the import side, wheat takes the first place, with the Argentine as the chief supplier. Cotton imports from Brazil have also been considerable. In 1940 the turnover of foreign trade amounted to 737 million gold pesetas, with an import surplus of 147 million (the corresponding figures for 1935 were 1,458 million and 292 million).

Thanks to its geographical position, Portugal has been able to maintain foreign trade at a high level and to derive considerable profits from an extraordinary expansion in its foreign transit trade, which in 1941 reached a value of Esc. 1,235 million, compared with Esc. 71 million in 1938. For the first time in a decade the trade balance closed in 1941 with an export surplus amounting to Esc. 428 million. The volume of imports in 1941 was 38 per cent. less than in 1938; the increase in import prices was probably less pronounced than in most other countries, Portugal being less affected by the rise in transport costs than, for instance, Switzerland. Exports were 50 per cent. below the volume of 1938; reduction in the sale of bulky goods (such as water supplied to ships, pyrites and pit props) is responsible for this fall; on the other hand, certain valuable materials — in the first place tungsten — have gained considerably in importance. From 1938 to 1941 the export of tungsten rose in volume from 2,500 to 5,200 tons and, in value, from Esc. 18 million to 542 million, reflecting one of the steepest price rises during the present war. While a country whose prosperity normally depends on the marketing of a few heterogeneous commodities, such as cork, tinned fish, port wine and olive oil, Portugal has been able to profit from an intense demand for some of its products usually of little consequence. In the first half of 1940 four-fifths of all exports were sent to Great Britain, but in the following months increased shipping difficulties led to a resumption of the continental trade. Wartime shortage of tin-plate at one time seriously threatened the sardine-canning industry but arrangements were concluded under which the belligerents provided the required tin-plate in order to obtain the 1941 output of sardines.

No data whatever have been disclosed since the beginning of 1941 regarding the foreign trade of the United Kingdom. Some indirect indication is, however, furnished by the foreign-trade statistics of the United States available up to September 1941.

British-American Trade.

In millions of dollars	1939	1940	1941
	January to September		
U. S. Exports to:			
United Kingdom	371	698	1,024
Other British Empire countries	532	767	1,079
Total	903	1,465	2,103
U. S. Imports from:			
United Kingdom	105	121	101
Other British Empire countries	465	702	981
Total	570	823	1,082

The value of British exports to the United States thus declined notwithstanding a rise in prices. Imports from the United States increased progressively, being aided by the passing of the Lend-Lease Act in March 1941. Thereafter, it was possible to limit exports to the minimum needed to pay for essential imports outside lend-lease and to furnish British and certain other countries with essential supplies. The main items of British exports to the United States (whisky, raw wool, woollen goods, linen, etc.) do not depend to any great extent on imported raw materials. The programme initiated early in the war, under which the British Government undertook to purchase or to underwrite the entire exportable surplus of large quantities of primary products of the Dominions and colonies, was substantially continued in 1941, although, owing to increased shipping difficulties, the amount of stocks accumulating in the producing areas must have risen considerably.

Eire being a creditor country, the trade balance is normally passive but became active for the first time in 1941, the export surplus amounting to £2.3 million. This reversal was due to a shrinkage in imports from £46.8 million in 1940 to £29.5 million in 1941, while the decline in exports was only from £33.0 million to £31.8 million. More than three-quarters of Irish exports consist of food products (livestock, meat and dairy produce) while the largest items on the import side are wheat and coal. 370,000 tons of wheat are considered necessary for home consumption: from 1939 to 1941 the area under wheat nearly doubled and the wheat crop for 1942 is estimated to be about 290,000 tons, which would make it the greatest since 1846.

In the year ending 30th June 1941, exports (including gold shipments) from Australia showed a contraction from £A 167 million to 151 million and imports from £A 145 million to 136 million, leaving an export surplus in 1940-41 of £A 15 million. The export figures represent merchandise and gold actually shipped, while, under contracts with the British Government, Australia receives payment for some exportable commodities, such as wool, whether they are shipped or not. As part of the government plan to restrict consumption, it was announced in December 1941 that drastic cuts would be made in the imports of non-essential consumption goods from sterling-area countries also (except New Zealand). While from January 1942 the publication of Australian trade statistics was suspended for the duration of the war, trade figures for New Zealand are available for the year ending 31st March 1942.

Trade of New Zealand.

In millions of £NZ	1940-41	1941-42
	April to March	
Exports	71	69
Imports	48	51
Balance	+ 23	+ 18

Exports have been concentrated mainly on goods covered by the war agreement with the United Kingdom. Under petrol restrictions and control of foreign trade, imports of motor vehicles have almost disappeared and imports of goods which can be produced in New Zealand and of materials for public works have been greatly reduced.

As the last of the British Dominions to adopt such a measure, the Union of South Africa from 15th September 1941 introduced a ban on imports from non-sterling-area countries, i. e. made imports from these countries conditional upon a government permit. The country most affected was the United States, from which imports in 1941 amounted to £SA 35 million compared with British shipments to the value of £SA 30 million. Total imports in 1941 came to £SA 100 million against £SA 96 million in the previous year. Gold sales to the Bank of England have been estimated at £SA 119 million and sales of wool under an agreement with the United Kingdom at £SA 10 million, while other exports amounted to £SA 31 million, leaving an export surplus of about £SA 60 million.

Canada's external trade in 1941 broke all previous records, exports and imports increasing by 30 per cent., in comparison with the previous year, to twice the figures for 1939. The war has intensified the customary trend of Canadian trade, characterised by an export surplus in relation to the United Kingdom and other overseas countries and a substantial import surplus in trade with the United States.

To meet the difficulties arising from an increasing shortage of U. S. dollars, new measures had to be taken in addition to the taxes and import

Foreign Trade of Canada.

In millions of Can. $	1940	1941
Total exports*	1,389	1,841
Total imports	1,043	1,346
Balance . . .	+ 346	+ 495
Exports to British Empire . .	689	1,002
Imports from British Empire	244	279
Balance . . .	+ 445	+ 723
Exports to U.S.A.	417	572
Imports from U.S.A.	744	1,004
Balance . . .	— 327	— 432

* Including net non-monetary gold.

restrictions adopted in 1940. Under an agreement concluded with the United States in April 1941, Canada was to supply the United States within a year with defence articles to the value of some $200–300 million, while the United States would supply Canada with American components in goods manufactured in Canada for the United Kingdom, passing such items through the lend-lease account of the United Kingdom. It was calculated that the two measures would relieve Canada of the necessity of finding $400–600 million, or about two-thirds of its U.S. dollar requirements for 1941. Canada was the only country in the western hemisphere able substantially to increase its wheat exports in 1941. They amounted to $162 million (197 million bushels) compared with $120 million (139 million bushels) in the previous year. Canada's trade relations with Latin America were further developed: imports almost doubled, amounting to $60 million compared with $32 million in 1940 and $33 million in 1929; exports also increased, although not in the same degree and without reaching the 1929 level, being $32 million in 1941 compared with $27 million in 1940 and $45 million in 1929.

For the full year 1941 certain global figures of the foreign trade of the United States are available, no detailed data being published for any month after September 1941.

The export surplus rose in 1941 by $405 million or about 30 per cent. A further increase occurred at the beginning of 1942: the Commerce Department has reported that for the first four months of 1942 the export surplus of the United States totalled $1,250 million (excluding shipments to U.S. armed forces abroad).

Foreign Trade of U.S.A.

In millions of dollars	Exports*	Imports	Balance
1940	4,021	2,625	+1,396
1941	5,146	3,345	+1,801

* Including re-exports.

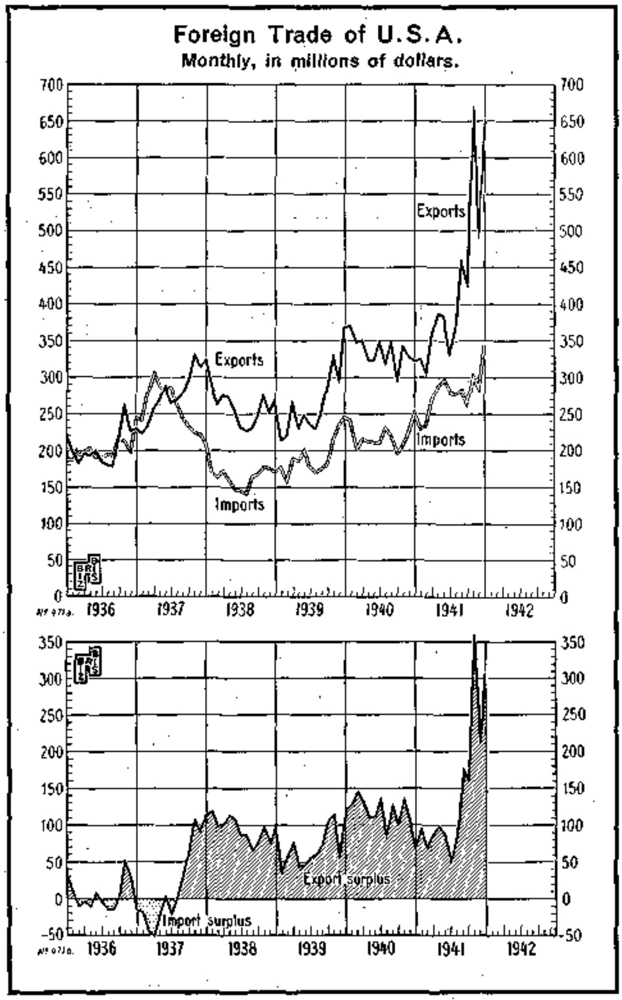
According to a statement by the Bureau of Census, exports and imports in 1941 were greater in volume than for any other year in the nation's history. In value, exports (including lend-lease shipments) were 64 per cent. higher than in 1938 and had in the past been exceeded only in 1929 and during the years 1916–20; imports were 65 per cent. higher than in 1938 but also below the 1929 peak, when, however, as in 1916–20, commodity prices were higher than in 1941.

The composition and direction of the foreign trade is shown in the following table for the nine-month periods January to September.

Composition and Direction of U.S. Foreign Trade.

In millions of dollars	Exports 1940	Exports 1941	Imports 1940	Imports 1941	Balance 1940	Balance 1941
	January-September					
By groups:						
Raw materials	382	226	718	990	—	—
Foodstuffs	194	262	428	502	—	—
Semi-manufactures	689	540	416	523	—	—
Finished manufactures	1,697	2,209	310	301	—	—
Total *	2,962	3,237	1,872	2,316	+ 1,090	+ 921
Direction:						
U. K.	698	1,024	121	101	+ 577	+ 923
Canada	511	675	301	391	+ 210	+ 284
South America	337	331	280	470	+ 57	— 139
Asia and Oceania	530	530	727	926	— 197	— 396
All other areas	951	758	513	529	+ 438	+ 229
Total *	3,027	3,318	1,942	2,417	+ 1,085	+ 901

* The difference between the totals is due to the fact that in the classification by groups only "domestic exports" and "imports for consumption" are included, while, in the classification by direction, exports include re-exports and imports are "general imports".



Exports of finished manufactures (mostly armaments) have further increased, replacing to some extent the metals and other semi-manufactures so prominent among exports during 1940. Shipments of foodstuffs (especially milk and meat) to the British Empire have been steadily increasing since the passing of the Lend-Lease Act, but the agricultural group as a whole shows a reduction, mainly due to a further shrinkage in cotton exports. In fact, agricultural exports (including cotton and tobacco) fell to the lowest level since 1869. Imports show a reverse picture: fewer finished products were imported but more raw materials, foodstuffs and semi-manufactured articles, partly for accumulation of stocks.

With regard to the direction of trade, there was further concentration on exports to the United Kingdom and

Canada, exports to other areas remaining unchanged or, in some cases, falling. The value of lend-lease goods actually exported from the time of the passing of the Act in March 1941 to the end of November of the same year was $595 million, exports to the British Empire and Egypt making up more than 90 per cent. of the total. Other forms of lend-lease aid include the building-up of stocks at American ports, the manufacture and use of goods in the United States, servicing and repair of ships, rental and charter of ships, as well as other production facilities. Were all such items taken into account, the total lend-lease aid up to the end of November 1941 would reach $1,202 million.

On the import side, proportionately the largest rise (by nearly two-thirds) occurred in trade with South America. Asia and Oceania still occupied the first place as foreign suppliers of the United States; the importance of the trade with countries in this part of the world may be seen from the accompanying table, covering twelve-month periods up to the end of September.

U. S. Foreign Trade with some countries of Asia and the Pacific Area.*

In millions of dollars	1939	1940	1941
	12 months ending September		
Exports	296	413	521
Imports	435	708	970
Total turnover	731	1,121	1,491

* British India, British Malaya, China, Dutch Indies, Philippine Islands, Australia and New Zealand.

The commercial relations with the areas included in the table have been much more important than the trade with Japan, which in recent years had fallen rapidly. During the first nine months of 1941 the turnover with Japan was in fact only 2 per cent. of the foreign trade of the United States, against 7 per cent. during 1939.

In consequence of the extension of hostilities in Asia, it is likely that inter-American trade relations will show a further substantial expansion.

U. S. Trade with Latin America 1939–41.

12 months ended September	In millions of dollars			Percentage change	
	1939	1940	1941	1941 from 1939	1941 from 1940
U. S. Exports to Latin America	500	738	809	+ 62	+ 10
U. S. Imports from Latin America	470	615	872	+ 86	+ 42
Balance . . .	+ 30	+ 123	— 63	.	.

During the two years to September 1941 Latin American exports to the United States increased by about 85 per cent. and imports from the United States by 60 per cent. From the table it appears that the trade balance was reversed from 1940 to 1941, but the figures represent values in U. S. ports, without therefore taking into account freights, insurance, etc. With the outbreak of war and the more or less complete severance of trade relations with Continental Europe, Latin American countries were confronted with the problem of finding new markets for a considerable part of their exports and new sources of supply for an equally considerable part of their imports, the aggregate value of which came to about $1,000 million in 1938. With this object, their policy was chiefly directed towards the double aim of transforming their internal economy, in order to lessen their dependence on the outside world, and of fostering inter-American trade relations. This twofold policy, already initiated in 1940, made further progress during 1941. In order to foster industrialisation and diversification, measures of various kinds were taken, such as the granting of duty and tax exemption on industrial and agricultural equipment and materials from abroad, the ready provision of exchange for such imports, and the imposition of protective duties on the corresponding finished products. Brazil has taken the lead, becoming the most important industrial power in South America, followed by the Argentine and Chile. The most outstanding development has taken place in the textile industry, the growth being particularly rapid in the more populous countries, where the consumers' purchasing power was higher, and in the countries producing the necessary raw materials, chiefly wool and cotton. But industries producing raw materials necessary for the war (such as oil, tin, copper, etc.) have also been encouraged and plans have been established for large-scale developments, as, for instance, of rubber plantations in Brazil.

One of the chief obstacles confronting the process of industrialisation lies in the difficulty of obtaining the necessary machinery at a time when the United States and Great Britain have to concentrate on their own war efforts. Particular consideration is, however, given by the United States to the needs of the Latin American countries; special organisations for that purpose have been set up in Washington and the list of controlled products which can be freely exported to Latin America under a "general licence" has been enlarged.

Another set of measures intended to meet the situation arising from the war includes, on the one hand, agreements — with the United States as well as Great Britain — for the purchase of strategic and other products and, on the other hand, support given by various Latin American governments to surplus commodities on their own markets. Purchases by the United States cannot possibly be extended to cover all surplus products, especially where the United States itself has an excess production (e. g. wheat); in these cases individual governments have intervened, by buying the bulk of current crops (the Argentine) or by granting loans to producers (Brazil) or by buying the existing surpluses (Colombia, Paraguay and Uruguay). The general nature of the arrangements with the United States for the purchase of surplus products may be illustrated by the agreement concluded in July 1941 between the United States and Mexico, under which the Mexican Government undertook to restrict the exports of certain of the country's strategic and "critical" materials to points within the western hemisphere. On the other hand, the United States undertook to buy, at the market price current at the time of purchase, any quantity of these commodities not sold to private industries in the western hemisphere. At the end of 1941 the United States announced the purchase of the entire Cuban sugar surplus of 1942 at slightly above prevailing prices.

To further their mutual trade relations, a number of Latin American countries have concluded with one another agreements generally based upon reduction or stabilisation of duties on selected products, and providing for a more or less wide application of the most-favoured-nation clause. Thus, an agreement between Brazil and the Argentine extended reciprocal facilities especially to newly-created industries. With a few exceptions, the competitive or non-complementary character of the economies of the Latin American countries limits the influence which such agreements can exert on the interchange of goods. New difficulties are likely to arise for Latin American countries as a consequence of the war in the Pacific. With the exception of Peru, which after Egypt and the United States is the world's largest producer of long-staple cotton and has depended on Japan as an important outlet for this product, the share of exports to Japan amounted to an average of 10 per cent. of the total exports of the larger South American countries. The major decrease will, in general, fall upon cotton. The surplus output of long-staple cotton of Peru has been purchased in its entirety by the United States for the duration of the war and the United States has also made arrangements for purchases of cotton from other Latin American countries.

Foreign Trade of Latin American Countries.

In millions of currency units		Exports		Imports		Balance	
		1940	1941	1940	1941	1940	1941
Argentine	Peso pap.	1,629	1,640	1,499	1,277	+ 130	+ 363
Bolivia	£	13	15	6	·	7	·
Brazil	Milreis	4,961	6,729	4,964	5,514	— 3	+ 1,215
Chile	Peso or	679	782	506	525	+ 173	+ 257
Colombia	Peso	166	176	148	170	+ 18	+ 6
Cuba	Peso	127	212	104	134	+ 23	+ 78
Mexico	Peso	960	713	669	916	+ 291	— 202
Paraguay	Peso or	11	15	15	12	— 3	+ 3
Peru	Sol	406	494	319	358	+ 87	+ 136
Uruguay	Peso	110	116	74	58	+ 36	+ 58

Contrary to pessimistic forecasts regarding the foreign trade of the Argentine for the year 1941, this trade was well maintained, the total turnover being, in value, only 6 per cent. below that of the previous year. The decline was due to a fall in imports by 15 per cent., while the value of exports was practically unchanged. Less wheat, flax and maize was exported but these reductions were more than offset by increased shipments and higher prices for meat, wool, hides, dairy products, fruit and even some industrial articles. The trade balance closed with an export surplus of Pesos 363 million. For the first time for many years the Argentine had a surplus of exports in relation to the United States. In general, there has been a shift towards intensified continental trade, the share of Brazil in Argentine imports having almost doubled. A trade agreement was concluded with the United States in October 1941 (the first of its kind since 1853), providing for some mutual tariff reductions and the application of most-favoured-nation treatment to imports from the United States.

In value, Brazilian exports rose in 1941 by 35 per cent. and imports by 11 per cent., with an export surplus of Contos 1.2 million, while in the previous year exports and imports were in equilibrium. Apart from fuel (petrol and coal), supplies of imported articles were declared satisfactory. The Brazilian trade position has been strengthened by the development of the country's mineral wealth as well as by the stimulus given, in particular, to the cotton industry, which was grown sufficiently large to provide for exports in addition to domestic requirements. Some 80 per cent. of Brazilian total exports went to other countries in North and South America, as against 50 per cent. in 1940. Coffee and cotton, though less important than they were, still represent 45 per cent. of Brazilian exports.

In the foreign trade of Chile, the share of American countries rose from 30 per cent. before the war to 74 per cent. in 1941. The export surplus increased from 173 million gold pesos in 1940 to 257 million in 1941. Great Britain and the United States have together given an undertaking to buy the whole saltpetre production for the season 1941–42, and agreements concerning other products have also been concluded. Peru had an increased export surplus, due mainly to shipments of oil and cotton. Heavy exports of wool benefited the trade balance of Paraguay and Uruguay, and in Venezuela increased oil exports helped to ease the exchange position. In Colombia the export surplus amounted to Pesos 6 million, coffee accounting for 45 and petrol for 25 per cent. of the exports.

In Central America the countries are economically closer to the United States and less dependent on European markets than the countries further south. For the first time for many years, Cuba can now dispose of its whole available surplus of sugar by exports to the United States. Mexico was able to increase some of its exports in 1941, registering a noteworthy advance especially in quicksilver; but the import surplus increased in comparison with the previous year. Loans and credits granted by the United States (see page 35) and other movements of funds have, however, made it possible to meet without difficulty the increased demand for dollars.

In order to enable the Latin American countries to overcome the difficulties caused by the severance of trade relations with Europe, it appeared for some time as if large-scale credit assistance by the United States would be absolutely necessary. The favourable development of exports, however, together with the less desirable shrinkage in imports, has, generally speaking, strengthened the exchange position of these countries and even made it possible for them in some measure to ease their restrictions on the allocation of foreign exchange. The balance of payments as such gives, as a rule, little cause for anxiety compared with the very real difficulties of disposing of surplus products, of finding sufficient shipping facilities and of ensuring minimum requirements of essential imports.

For the Dutch Indies also, severance of relations with the European continent led to great changes in the direction of trade. While in 1938 Europe as a whole accounted for nearly two-fifths of the foreign commerce, by 1941 the European trade (almost exclusively with Great Britain) constituted barely one-twentieth of the total. The loss in this direction was, however, offset by increased trade with other countries in Asia and with the United States. Exports to Japan doubled in value from 1939 to 1940 but did not even then reach the figure of Fl. 50 million, out of total exports in 1940 amounting to Fl. 874 million. The war also altered the composition of the country's trade: exports of agricultural products (tea, coffee, sugar, etc.) declined, but exports of strategic materials (rubber, tin, petroleum) increased. In 1940 the export surplus of Fl. 429 million was the highest since 1929, with the exception of the year 1937, when it had been 455 million.

Detailed statistics of imports from the yen-bloc countries into North China and other Japanese-occupied ports are no longer published. Unofficial attempts have been made to arrive at estimates for the first half of 1941; since, however, a large proportion of China's imports from Japan (i.e. for the account of the Japanese military authorities), as well as from non-yen-bloc countries (i.e. purchases by the National Government in Chungking) are not recorded in the customs statistics, no reliable picture can be obtained of the actual size and distribution of China's foreign trade. Moreover, the difficulties are increased by different methods of calculation and of payment, and by the variety of monetary units. The valuation of exports is affected by similar difficulties; as far as can be seen, there was a general decrease in exports during 1941.

Japanese Foreign Trade.

In millions of yen	Imports	Exports	Balance
1936 . .	2,925	2,798	— 127
1937 . .	3,903	3,254	— 649
1938 . .	2,836	2,896	+ 60
1939 . .	3,127	3,933	+ 806
1940 . .	3,709	3,972	+ 263

Since September 1940 Japan has suspended the publication of her detailed foreign-trade returns, the last officially available data referring to the export and import figures for the whole year 1940. The accompanying table summarises the movements of Japanese foreign trade during the five years to the end of 1940.

This table clearly reflects the influence of political events in the Far East: prior to the Sino-Japanese hostilities in 1937, Japan evidently sought to secure abundant stocks, and this led to an increase in imports by about Yen 1 milliard and to a trade deficit of over half a milliard yen; subsequent to the establishment of a large area under Japanese control in North China, exports expanded in 1939 by Yen 1 milliard, with an export surplus at the record figure of over Yen 800 million, reduced by two-thirds in 1940 as a result of increased imports. The appearance of an export surplus in the years 1938 to 1940 was, however, due to trade with yen-bloc countries, the balance remaining constantly passive in relation to the so-called "free exchange countries". Trade with the United States fell sharply in the course of 1941: according to American statistics, the total turnover in August 1941 amounted to $2.2 million, against a monthly average of $20.6 in the first quarter of that year and of $30–40 million in the years 1936–38.

Some of the most noticeable trends in the currents of trade since 1939 by no means represent sudden and unexpected changes, the war having only helped to foster tendencies already existing; in other cases, however, trends which were in full development have suffered a setback, while elsewhere new developments have set in. Thus, the exports of Japan during the decade up to 1938 had already shown a tendency to expand in the area on the continent of Asia under Japanese influence, Japanese trade in this area having risen from 35 per cent. of the country's total exports in 1929 to 63 per cent. in 1938. In the period from 1932 to 1938 German trade with the six countries in south-eastern Europe increased from 4½ to 13 per cent. of Germany's total foreign trade, while imports of the United Kingdom from the continent of Europe represented only one-third of its total imports in 1938 as against two-fifths in 1929. These tendencies have been greatly accentuated by the course of the war. On the other hand, the relations between Latin America and Continental Europe, which in recent years had been making steady progress, were almost completely interrupted at the outbreak of the war. Finally, a new development, of considerable proportions, has been the extension of trading within the western hemisphere to commodities which had previously been sent to or obtained from other continents.

For the moment commercial policy is dominated by the exigencies of war and in particular by the need of securing essential supplies under most difficult circumstances and for a period of time the length of which cannot yet be foreseen. But, just as in the internal economies of the different countries the immensely increased war production must one day, when hostilities have ceased, give place to production for civilian purposes, so the currents of trade now determined by the war must again be governed by peacetime needs. That does not necessarily mean that all the developments provoked by the war will prove purely temporary; but, because present-day organisation has to be arranged for the supreme needs of the war, it cannot be expected to meet the requirements of peace.

3. PRICE MOVEMENTS.

In the Introduction (see pages 17—19), attention has been drawn to the divergency between the virtual stability of the German price level since the beginning of the war and the comparatively large increases elsewhere, the main aspects of this divergency being illustrated by some observations on the price policy pursued in Germany, Switzerland, the United Kingdom and the United States.

The essential elements of the German price control have been the price stop, introduced before the war and extended in 1939 and 1940 to include a wage and a profit stop, and the comprehensive system of rationing, which in a large measure has prevented the surplus purchasing power in the hands of the public from exerting its influence as effective demand. Many complicated problems have, of course, arisen in particular sections of the price and cost structure, for which solutions have had to be found in the light of the general principles governing the price policy. In the armament sector a change was introduced in the winter of 1941–42: instead of calculating on a cost basis the price payable to each individual producer, prices in armament contracts were fixed uniformly, for the whole of the country or for certain groups, on the basis of the cost of a "well-run enterprise". It was explained that this change aimed at enlisting more specifically the profit motive to stimulate rationalisation in war industries; under the old system, with prices fixed on a cost basis for each individual firm, the producer did not benefit from a reduction in his costs. It was also provided that those firms which would be paid uniformly-fixed prices, or belonged to a group for which the lowest group-price had been fixed, would no longer be subject to the "Gewinnabschöpfung" (the skimming-off of profits) which, independently of taxation, was imposed by the Price Commissioner on firms with profits out of proportion to their turnover. Up to the end of February 1942, this "Gewinnabschöpfung" had yielded an amount of RM 232 million.

Where an increase in the price has been authorised in order to encourage the output of certain agricultural products, higher living costs for the consumers have to some extent been avoided by the granting of subsidies, as a rule paid out of so-called "Ausgleichskassen" (equalisation funds). These funds obtain their revenue partly from levies on producers with a high earning capacity and partly from the government. It is estimated that in 1941 the total subsidies to agricultural producers came to about RM 800 million, of which about three-quarters was paid by the government*. Efforts have also been made to provide a partial compensation for unavoidable price rises by lowering the prices of certain selected articles (such as electric bulbs); it was hoped that this would also produce a certain psychological effect, making it clear that no all-round increase in prices would be permitted.

At the beginning of the war, the German price level, calculated at the official exchanges rates, was higher than that of other countries in which the currency had depreciated in terms of gold and, as pointed out on page 19, this helped to make Germany to some extent immune from the effects of price increases in other countries. But, as the price advance became more pronounced elsewhere on the continent of Europe, certain repercussions were felt also in Germany, as may be seen from the figures in the table on page 67; and stress began increasingly to be laid upon the desirability of arriving at a "European price stop", covering, in particular, the prices of import and export goods. For most countries import prices have risen more than the domestic price level, partly as a result of increased transport costs but partly also because each country has been more or less bound to quote higher prices for what it sells, in order not to worsen its terms of trade. With a view to preventing the emergence of an uncontrolled and clearly unbalanced price rise in the

* "Der Deutsche Volkswirt", 6th March 1942.

Germany: prices of raw materials.

Indexes on base 1913 = 100	Raw material prices preponderatingly determined by domestic conditions	foreign conditions
1938 (average) . .	104.3	71.0
1939 August. . .	104.7	71.0
December .	103.8	74.1
1940 December .	103.1	87.0
1941 December .	102.5	96.0

foreign trade sectors, it has become a regular practice in commercial negotiations to fix the price of the most important commodities exchanged between the countries. Thus, Germany and Italy agreed in October 1941 on the principle of a price stop applicable to their export relations and, in March 1942, prices were fixed for different groups of important commodities, including coal, iron and steel, other metals, artificial fertilisers, sugar and a number of chemical products exported from Germany, and hemp, silk, Zellwolle, artificial silk, sulphur and sulphur pyrites, bauxite, tobacco, fruit and vegetables exported from Italy. It is reported that, in volume, the trade turnover between Germany and Italy has risen threefold as compared with 1935-36, when closer collaboration had not yet been established between the two countries. Thus, German deliveries have risen from RM 200 million to RM 600 million, calculated at the old prices, while, at current prices, present deliveries amount to about RM 1 milliard. From this it might be concluded that German export prices in relation to Italy are now as much as 50 per cent. higher than they were in the middle of the 'thirties.

In fixing export quotas, Italy, like other countries, has had due regard to the requirements of home consumption, in order to prevent a rise in prices caused by an increased scarcity of certain commodities. Price statistics have not been published since the war; it is known, however, that up to 1940 indexes of cost of living and of wages showed a parallel movement, the cost of living having risen by 22 per cent. (in Rome) and hourly wages by 21 per cent. since 1938. Further wage increases were granted in 1941; support has, in particular, been given in the form of increased family allowances. The Italian price control has taken account of the rise in the cost of imports and of the need of stimulating production, especially in agriculture. The so-called system of "ammassi", originally applied to wheat, has been gradually extended to cover twenty-three staple commodities, including maize, rice, eggs, milk, cattle, etc. Under this system the farmer is obliged to sell to the state, at a fixed price, the whole of his production, after deducting a part for his personal consumption and such purposes as sowing. Generally, the price paid to the producer is higher than that at which the state resells the commodities. The task of fixing prices was at first entrusted to different departments, primarily the Ministry of Agriculture and the Ministry of Corporations. An attempt at coordination was made in July 1941, when a Central Committee for the Control of Prices was appointed. It was, however, felt that a more unified control with fuller powers was needed and, in January 1942, a new interministerial committee was created under the leadership of the Duce, including among its members the Governor of the Bank of Italy.

In the Danubian and Balkan countries, 1941 was a year of considerable price rises.

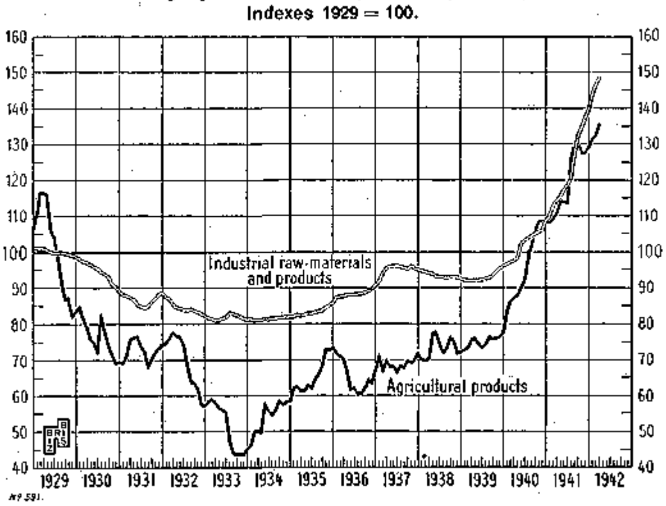
Price movements in Danubian and Balkan countries.

Percentage price increase during:	1939 2nd half	1940 1st half	1940 2nd half	1941 1st half	1941 2nd half	June 1939 to Dec. 1941
Bulgaria:						
Wholesale prices	+ 5	+ 3	+ 22	+ 6	+ 20	+ 69
Cost of living	+ 2	+ 4	+ 13	+ 8	+ 23	+ 60
Greece:						
Wholesale prices	+ 12	+ 8	+ 8			
Cost of living	+ 3	+ 9	+ 8	+ 35 (1)	+148 (2)	+304 (3)
Hungary:						
Wholesale prices	+ 5	+ 11	+ 10	+ 7	+ 19	+ 62
Cost of living	+ 1	+ 6	+ 8	+ 5	+ 14	+ 39
Roumania:						
Wholesale prices	+ 24	+ 26	+ 21	+ 28	.	+144 (4)
Slovakia:						
Wholesale prices	.	.	+ 3	+ 8	+ 8	+ 60 (6)
Cost of living	.	+ 20 (7)	— 2	+ 9	+ 15	+ 48 (6)
Turkey:						
Wholesale prices	+ 9	+ 6	+ 17	+ 17	+ 21	+ 92
Cost of living	+ 6	+ 4	+ 9	+ 9	+ 13	+ 47
Yugoslavia:						
Wholesale prices	+ 17	+ 16	+ 36	.	.	.
Cost of living	+ 13	+ 17	+ 13	+ 17 (5)	+ 36 (5)	+139 (5)

(1) December 1940 to July 1941.
(2) July 1941 to November 1941.
(3) June 1939 to November 1941.
(4) June 1939 to June 1941.
(5) Refers to Croatia (Zagreb).
(6) January 1939 to December 1941.
(7) January 1939 to June 1940.

Since the beginning of the war, the price policy of Hungary has been purposely directed towards an improvement in the earning capacity of agriculture. Although by 1939 agricultural prices had recovered considerably from the low level to which they had fallen in the depth of the depression, it was only towards the end of 1940 that they attained the 1929 "parity" in relation to other prices. The President of the National Bank of Hungary explained in his speech at the general meeting of the bank, held in February 1941, that the change which had occurred during the war in the valuation of farm products gave Hungary a welcome opportunity to bring about

Hungary: Wholesale prices by groups.
Indexes 1929 = 100.



a new distribution of income in favour of the agricultural sector by adapting its prices of farm products to those of the importing countries in Europe. This shift in the income distribution appeared economically and socially necessary, since the depressed prices for farm products had brought down the standard of living of the agricultural population to an intolerably low level, and the unreasonable remuneration had, moreover, discouraged agricultural enterprise. Adaptation of farm prices to the European level was also indicated from the point of view of the terms of trade. From the time of the agrarian crisis these terms had been unfavourable to Hungary, and not until the price increases in 1941-42 was the disproportion rectified. By the end of 1941 the cost of living in Hungary had risen by about 40 per cent. above the 1939 level, while wages of industrial workers had been raised by about 30 per cent. Agricultural labourers as a rule receive a considerable part of their pay in kind.

In Slovakia, the cost of living rose more rapidly during 1941 than the level of wholesale prices. As from 23rd February 1942, enterprises with more than ten employees have not been allowed to reduce or raise wages or make extraordinary payments to their employees without authorisation by the Central Labour Office. Price statistics ceased to be published in Roumania in the middle of 1941. A "price stop" was decreed on the basis of the price relations on 1st September 1941, but substantial increases have been authorised in several instances after that date. The price developments in Bulgaria since the beginning of the war may be seen from the following table.

Bulgaria: Price Indexes.

Base January-June 1939 = 100	General wholesale prices	Import prices	Export prices	Prices of domestic products for home consumption	Cost of living
1939 January-June . .	100	100	100	100	100
1940 December	132	150	120	136	120
1941 June	139	161	119	149	130
December	168	167	152	181	160

For the first two years of the war, the increase in the Bulgarian price level was dominated by a pronounced rise in prices of imported commodities but, from the middle of 1941, domestic influences have been preponderant, the prices of export products, and still more of domestic products for home consumption, advancing at a rapid rate. The cost of living has risen practically as much as the level of wholesale prices. This unusual development probably reflects the difficulties of introducing, in an agricultural community, an effective system of rationing or such measures as the granting of subsidies to producers in order to limit the rise in prices for the consumers. In Turkey, as in Bulgaria, the rise in prices first affected imports but, in the course of 1941, a sharp increase lifted the prices of exported goods and of goods produced for the home market above the level reached in the import trade. According to the official index, the average of wholesale prices of foodstuffs doubled between 1939 and 1941 and, in the early months of 1942, further advances occurred.

The Protectorate of Bohemia and Moravia is autonomous in questions of prices but adaptation to the German price level was intensified by the abolition of exchange restrictions with Germany and inclusion in the German customs area from the autumn of 1940. The principle has been adopted that the upper limit for price changes in the Protectorate shall be the prices ruling in the rest of the Reich territory, it being incumbent on the control to maintain, wherever possible, a certain margin below the German level. For deliveries from the Protectorate to the rest of the Reich, the highest prices which may be charged are those quoted for similar products in the rest of the Reich. For German sales to the Protectorate, the prices must not be higher than for sales on the internal market in Germany. The same rule applies to German exports to certain of the occupied areas, in particular to trade with Holland.

No price statistics are published for Holland or Belgium: Holland is the more closely connected with the German economy, all exchange restrictions and customs duties between the two countries having been abolished in 1940 and 1941. As a rule, Dutch exports to Germany have to be made at the same prices as those obtaining in Holland, but the German price control can authorise an increase when the price on the German market is higher than that in Holland. Dutch exports to other countries than Germany are not subject to the internal Dutch price regulations.

Similar provisions apply to German imports from some other countries such as France and Belgium and, in particular, to contracts, which under organised schemes have been placed in the countries concerned. Considerable difficulties have, however, in many cases been encountered by the fact that costs and prices have been rising, often rather steeply, in these countries and the German price control over imports from them has been tightened to ensure that exceptions will only rarely be granted from the rule that German prices must not be exceeded.

No official price index has been published in France since the beginning of the war, but the Office of General Statistics has resumed the publication of a large number of wholesale and retail prices and, on the basis of these and other data, various institutes have proceeded to calculate general price indexes.

France: Price Indexes.

Base: August 1939 = 100*	Wholesale prices	Retail prices	Cost of living
1939 August	100	100	100
December . .	128	110	111
1940 December . .	162	132	130
1941 December . .	196	151	150
1942 March	199	154	153

* Indexes calculated by "La Conjuncture Economique et Financière".

According to these indexes, which are based on regulated prices, wholesale prices have doubled and retail prices and the cost of living have increased by 50 per cent. since August 1939. The wholesale price index may be taken to reflect the actual position fairly well, the prices of raw materials — both industrial and agricultural — being effectively controlled. Prices of manufactured articles, which to some extent enter into the calculation of the index, have as a rule risen more than the general index figure.

The indexes of retail prices and the cost of living reflect the comparatively moderate increase in the prices of commodities subject to rationing, but the rations are small and must be supplemented by purchases of other commodities. Many of those commodities can be bought in legally free markets, though at prices which have usually risen considerably — often by as much as 200 per cent., as in the case of fruit and vegetables. The amounts actually spent on food by the mass of consumers depend essentially on the possibilities of supplementing the insufficient rations by purchases of free commodities. Besides the black markets, where at least in the towns the prices are so high that people with low or moderate incomes find them beyond their reach, account must be taken of the great number of barter transactions in a variety of forms and the substantial volume of trading in country districts, as well as the goods sent by members of a family to one another. Increased transport difficulties have led to considerable local differences in supply and in the prices charged. After a rapid rise in 1940–41, the various price indexes show a slowing-down of the upward movement, but it is probable that the disparity between the prices of different categories of commodities has become more accentuated.

Price movements:
Denmark, Finland, Norway, Sweden and Switzerland.

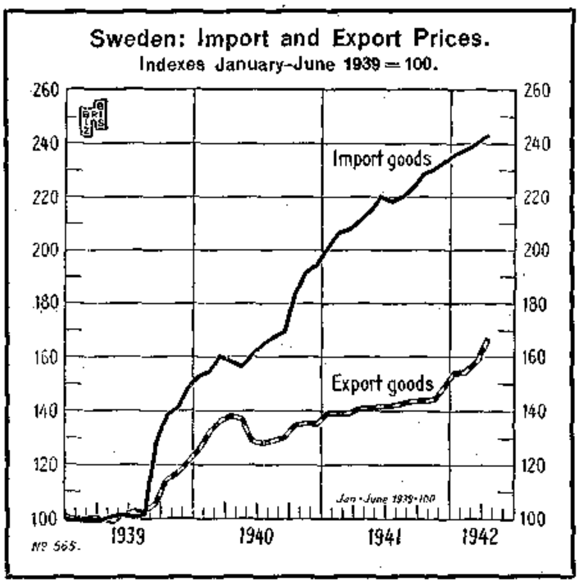
Percentage price increase during:	1939	1940		1941		June 1939 to Dec. 1941
	2nd half	1st half	2nd half	1st half	2nd half	
Denmark:						
Wholesale prices	+ 30	+ 15	+ 16	+ 6	+ 4	+ 91
Cost of living	+ 10	+ 15	+ 11	+ 7	+ 1	+ 51
Finland:						
Wholesale prices	+ 19	+ 18	+ 9	+ 10	+ 8	+ 82
Cost of living	+ 8	+ 9	+ 11	+ 7	+ 8	+ 52
Norway:						
Wholesale prices	+ 19	+ 12	+ 13	+ 13	+ 3	+ 74
Cost of living	+ 6	+ 8	+ 13	+ 6	+ 3	+ 43
Sweden:						
Wholesale prices	+ 21	+ 8	+ 12	+ 8	+ 3	+ 64
Cost of living	+ 5	+ 8	+ 6	+ 7	+ 4	+ 34
Switzerland:						
Wholesale prices	+ 18	+ 11	+ 18	+ 12	+ 8	+ 88
Cost of living	+ 4	+ 6	+ 7	+ 9	+ 5	+ 34

From the beginning of the war to the summer of 1941, wholesale prices in Denmark had risen by 85 per cent. and the cost of living by 50 per cent., but since then the increase has been greatly slowed down, if not wholly arrested. In two ways, in particular, the Danish authorities have reacted against the tendency of prices to rise. A "wage stop" was introduced in March 1941; in the autumn of that year the Arbitration Tribunal refused to grant an increase in wage rates, although the cost of living had risen substantially since the last wage adjustment. Industrial workers have had to accept a greater reduction in their standard of living than, for instance, has been sustained by the agricultural population, which, however, was relatively worse off before the war. In February 1942 the wage question was again under consideration and the Arbitration Tribunal then decided to allow an increase of 5 öre per hour to men over twenty-three years of age and 3 öre to women above that age, while no compensation was allowed to workers under twenty-three. The other way in which the authorities reacted was through the appreciation of the Danish crown by 8 per cent. in January 1942. Although the prices in crowns for Danish agricultural exports to Germany were to be maintained unchanged (except in so far as farmers' costs were reduced by cheaper imports), the appreciation could not fail to have some effect on prices of other goods handled in foreign trade, and it also exerted a certain psychological influence, indicating a firm determination on the part of the authorities to withstand a rise in prices by all means at their disposal.

By the spring of 1940 wholesale prices in Norway had risen by about 30 per cent. and the cost of living by about 15 per cent. from the summer of 1939. Immediately after the occupation of the country, a "price stop" and a "wage stop" were introduced: without official authorisation, prices could not be increased above the level on 8th April 1940, and wages, as well as salaries, were in future to be determined by the Social Department of the government. Nevertheless, the price level continued to rise; by the end of 1941 wholesale prices stood fully 70 per cent. above the level in the summer of 1939, and the cost of living over 40 per cent. There was, however, a slowing-down in the price increase from the autumn of 1941.

In Finland, on the other hand, the advance in prices continued in the winter of 1941–42 at about the same rate as previously. The index of wholesale prices in December 1941 stood at 80 per cent. above the level in the summer of 1939, and the index of the cost of living showed an increase of about 50 per cent. (with a further rise of 10 per cent. in the next five months). In February 1941 the government decided that, in principle, two-thirds of the increase in the cost of living should, on an average, be compensated by an increase in wages with, however, full compensation for the lower-paid workers. And in March 1942 a temporary Wage Board was appointed, with authority to control and fix wage rates and other conditions of work for the time of the emergency.

From March 1941 to the end of that year there was a distinct slowing-down in the price increase in Sweden, the monthly advance being about ½ per cent. But during the first five months of 1942 the upward movement again became somewhat more accentuated. No price stop has been imposed but so-called "normal prices" for a wide range of goods have been announced, these prices being determined in most cases through voluntary agreements with the commercial and industrial associations in different branches of economic life. The price control permits a price increase on account of higher direct costs; when the turnover has fallen, the firms affected are not entitled to distribute their fixed costs over the reduced volume. In a number of instances price increases have been allowed, not on account of increased costs but in order to stimulate production of essential commodities. Farmers have, on the whole, received compensation for the loss of income which would otherwise have resulted from the two exceptionally bad harvests in 1940 and 1941. In order to limit the rise in the cost of living, agricultural products have been given the benefit of comparatively large government subsidies, amounting to S.Kr. 223 million in the period September 1940 to August 1941 and estimated to attain S.Kr. 368 million for the corresponding period in 1941–42. The cost of living had risen in March 1942 by 37 per cent. above the pre-war level, and the wage rates of industrial workers by 19 per cent. Under the agreement in force between the organisations of employers and the trade unions in industry, compensation is given for about one-half of the increase in the cost of living. In the building trade, which has separate unions, the workers have received on an average compensation of less than 10 per cent.



The marked difference between the prices of import and export goods is shown in the graph. In trade negotiations during the winter of 1941-42 agreements were reached under which the prices of some of Sweden's more important export products were increased.

While living costs in Switzerland and Sweden have risen at about the same rate, the rise in wholesale prices is more pronounced in the former country, which is more dependent on imports of foodstuffs and raw materials. The Department of Industry, Trade and Labour in Berne continues to calculate and publish the ordinary cost-of-living index based on the consumption of an unchanged combination of goods and services. (The figures in the table on page 19 are from this index). But the Department (upon a proposal by a government commission appointed to advise on price and wage problems) has also calculated an "expense index", designed to measure the changes in the amounts needed to acquire the reduced supplies of goods and services now available. As regards commodities subject to rationing, account is taken of the allocated quantities only; for other commodities, the actual changes in supplies are calculated (and it has thus been found, for instance, that the consumption of potatoes has risen by 45 per cent. and of bread by 25 per cent.).

Switzerland: Expense Index.

August 1939 = 100	March 1942
Annual income up to 3,000 frs.	125
" " 3,000—4,000 "	122
" " 4,000—5,000 "	119
" " 5,000—6,000 "	119
" " above 6,000 "	117
Ordinary cost-of-living index	138

The greater increase in the index figure for the lower income groups is due mainly to the fact that these groups devote a larger percentage of their spending to the purchase of foodstuffs, the prices of which have risen more than the average. The expense index may be taken to indicate the increase in income which will enable each group to go on purchasing its share of the reduced supplies (according to the principle that a greater scarcity must be shared by all); and the government commission which devised the index could, therefore, recommend that it should be adopted as a basis for determining the compensation to wage-earners in respect of the higher cost of living. The rate of increase resulting from the expense index should not, however, be applied in a stereotyped manner; on the contrary, the commission expressly stated that the guiding principles which it had recommended in an earlier report (referred to on page 19 of the Introduction) should continue to be observed.

In several other countries also, there has been some question of calculating an index which takes into account the changes in consumption produced by the war. When certain commodities, such as coffee and sugar, have almost disappeared from the markets, some modification in the index is inevitable. In Germany, the index of food prices, which forms part of the cost-of-living index, has been computed according to the chain method since October 1939. At each calculation of the index, a household budget for food is established to reflect the actual consumption at the time, and the percentage change in the index since the last calculation is then computed according to this new budget. Care is taken, however, that the number of calories which go to make up each food budget remains constant. When the consumer has to buy more expensive commodities (as, e. g., when butter is distributed instead of margarine), the change is counted as a "genuine" increase in costs even when it means an improvement in the quality of the commodities consumed. If, on the other hand, consumption has turned to cheaper food (coffee substitute instead of coffee, etc.), this is not counted as a fall in the cost of living, since at the same time the quality of the commodity has altered. In a review* of the price developments during the first two years of the war, it has been pointed out that the amount saved by reduced consumption of, for instance, meat, fats, coffee, cocoa and soap is more than counterbalanced by an increased outlay on other commodities (potatoes, vegetables, coffee substitutes, etc.).

To what extent compensation shall be granted for the increase in the cost of living and the method of calculating the cost-of-living index have recently become matters of considerable public interest. As in Switzerland, a separate index is calculated in Denmark (in addition to the ordinary cost-of-living index), account being taken of the decrease in consumption due to rationing, etc. When the separate index is used more or less as a basis for wage increases (which is normally the case), the question has arisen whether

* "Wirtschaft und Statistik" 1941, No. 18.

adjustments should be made for increases in taxation affecting the level of prices (as, for instance, when a turnover tax is introduced). While it is usually recognised that it is an essential function of increased taxation to effect a restriction of consumption and that, therefore, an increase in the cost of living due to increased taxation should not, in principle, give rise to compensation, there are great practical difficulties in ascertaining what part of an increase in the cost of living may fairly be regarded as attributable to new taxation.

Price movements: Spain and Portugal.

Percentage price increase during:	1939	1940		1941		June 1939 to Dec. 1941
	2nd half	1st half	2nd half	1st half	2nd half	
Spain:						
Wholesale prices	+ 8	+ 9	+ 11	+ 14	+ 9	+ 62
Cost of living	+ 9	+ 6	+ 19	+ 13	+ 9	+ 68
Portugal:						
Wholesale prices	+ 16	+ 15	+ 8	+ 6	+ 3	+ 59
Cost of living	+ 2	+ 2	+ 7	+ 4	+ 15	+ 33

The rise in prices which began in Spain during the civil war continued more or less uninterruptedly up to the end of 1941. But, in the opening months of 1942, the indexes both of wholesale prices and of the cost of living showed practically unchanged figures. Export prices rose sharply up to the middle of 1941, until, in many cases, they surpassed the quotations in foreign markets at the official rates of exchange. These prices are shown to have fallen somewhat in the latter half of 1941 but, at the same time, prices of imported goods and of domestic products continued their upward tendency. Prices of most commodities are regulated by official control, with the effect, however, that the supply in the market at the prescribed prices has often proved insufficient to meet the current demand.

Thanks to its geographical position and also to the financial policy followed in recent years, Portugal is, of all the countries in Europe the one least affected by the war as regards the current supply of commodities — foodstuffs, for instance, being still unrationed in the spring of 1942. With the national budget in equilibrium, the impetus to a rise in the price level has clearly come from abroad. Prices of imported commodities, especially of coal and petrol, have increased, and some of the country's export products, notably tungsten, have risen violently in price. By the end of 1941 the repercussions of these increases had lifted wholesale prices by nearly 60 per cent. above the pre-war level, and the cost of living by over 30 per cent. The government — says the Banco de Portugal in its report for 1941 — is certainly not unable to react against these foreign influences; its reaction is, however, subject to certain limitations. Care must be taken that the restriction in consumption, which sooner or later inevitably ensues from the increase in prices, is so timed that the purchasing power of the poorer strata of the population, which even in peacetime could hardly have managed with less, is as fully maintained as possible.

Price movements: United Kingdom, Eire, United States and Canada.

Percentage price increase during:	1939	1940		1941		June 1939 to Dec. 1941
	2nd half	1st half	2nd half	1st half	2nd half	
United Kingdom:						
Wholesale prices	+ 25	+ 10	+ 11	+ 3	+ 2	+ 59
Cost of living	+ 12	+ 7	+ 5	+ 2	+ 1	+ 28
Eire:						
Cost of living	+ 12	+ 6	+ 5	+ 3	+ 8	+ 38
United States:						
Wholesale prices	+ 5	— 2	+ 3	+ 9	+ 7	+ 24
Cost of living	+ 1	+ 1	0	+ 3	+ 5	+ 11
Canada:						
Wholesale prices	+ 11	0	+ 3	+ 7	+ 4	+ 28
Cost of living	+ 3	+ 1	+ 3	+ 2	+ 5	+ 15

Since the spring of 1941 the increase in wholesale prices and in the cost of living in the United Kingdom has slackened considerably, partly as a result of increased government subsidies to keep consumers' prices down (see page 20) but partly also as a consequence of the reinforced price control. Since the war began, this control has passed through four different stages:

(i) During the first four months of the war, control was mainly limited to supervision of the prices of raw materials as they entered the country, the only limitation imposed on the general public being a restriction to approximately six gallons of petrol a month for owners of automobiles. The price level rose, however, not the least important factor being the 14 per cent. depreciation in the exchange value of sterling.

(ii) During the second stage, which began in January 1940 when the Prices of Goods Act, passed in November 1939, became effective, retail prices of a great number of commodities (excluding food) were fixed in relation to the prices prevailing on 21st August 1939, with allowance for increased costs.

(iii) The third stage was characterised principally by the introduction of rationing from the spring of 1940, a beginning being made with bacon, ham, butter and sugar. Later on, rationing was extended to other foodstuffs and also to textiles, for the particular purpose of reducing the import of raw materials.

(iv) In the spring of 1941 the new Goods and Services Act gave the government power to fix retail prices more rigidly than under the old act; to control margins of profit for manufacturers; to fix profits for such service industries as shoe reparing, furniture storage, pressing and cleaning; and to establish a system of inspectors to enforce the regulations.

With the prolongation of the war, rationing was extended to more and more commodities, and steps have, for instance, been taken to limit the cost of restaurant meals to a maximum of five shillings, and to provide so-called "utility clothing" at comparatively low prices. It has, in general, been found that the fixing of retail prices, to be effective, must be supplemented by rationing, since otherwise demand will soon exceed the available supply, with the result that the commodities "disappear" from the ordinary market, stocks are exhausted, etc. For luxury goods not subject to rationing, the increased rate of the turnover tax ($66^2/_3$ per cent.) acts as a brake on demand. The price control is administered by several departments, the Ministry of Supply, the Ministry of Food and the Board of Trade being the most important. The Board of Trade is in control of the retail trade and of civilian production, as well as all imports and exports not specifically assigned to other departments. In 1941 steps were taken to concentrate production for civilian purposes in about fifty different branches, in order to maintain efficiency when the total output was reduced, and to release workers for other tasks and storage room for stocks of war material, etc. It was announced in the spring of 1941 that about 200,000 workers, or one-fifth of the pre-war number, had been set free by these measures, and also about 55,000 square feet of storage room.

In Eire difficulties of obtaining normal supplies have led to many acute shortages and the introduction of extensive rationing. In 1941–42 Irish shipping capacity had largely to be reserved for imports of wheat. Prices of agricultural produce have risen on an average by 50 per cent. since the summer of 1939, and the cost of living by nearly 40 per cent. The government deficit to be covered by borrowing has been no larger than was usual before the war, so that the influences on prices are predominantly of external origin. Capital investment in housing and otherwise has been below normal and Eire has indeed been experiencing the symptoms of an economic depression, very different from the war-boom conditions which prevail elsewhere.

While in a great number of countries the rise in the price level slowed down during 1941, it was really only in that year that the upward pressure on prices began to make itself felt in the United States, wholesale prices rising by 17 per cent. and the cost of living by 10 per cent. Every major group included in the wholesale price index contributed to the rise, farm products showing the largest increase with an average of 36 per cent., followed by food and textiles (both closely related to farm products), which rose by 23 per cent. Apart from the basic influence of increased demand generated by the expenditure on armaments, the most important factors contributing to the price rise were the government farm programme, the growing shortage of shipping and the marked increase in wage rates. Prices of the main agricultural staples, like cotton, wheat, tobacco and maize, rose as a result of government action, notwithstanding large current production and, in some cases, huge accumulated stocks. The so-called government "loan rate", by which in fact active support is given to agricultural prices, was increased in the spring of 1941 for wheat and cotton from 56 to 85 per cent. and for maize and tobacco from 75 to 85 per cent. of the parity*. In the market, however, prices of these products rose somewhat above the loan rate, in

* The "parity" is intended to be the range of agricultural prices which gives the farmer the same purchasing power in relation to non-farm products as he had in 1909–14. The "loan rate" determines the price of the commodity at which farmers can borrow in full from the competent government agency.

anticipation of further action in favour of agriculture. In connection with the new measures taken in the early months of 1942 to control prices, the principle was adopted that maximum prices for farm products should not be fixed below 110 per cent. of "parity", the "loan rate", however, remaining at 85 per cent. Later on it was decided that for specific purposes (feeding of animals, and industrial uses) certain amounts of wheat could be sold at a price below parity from the stocks held by the government. Total wheat stocks are still considerable (see page 79) but stocks of cotton have been falling. In the spring of 1942 the domestic consumption of cotton attained a figure of 1 million bales per month as against a previous "normal" of 600,000 bales a month. At the high rate thus attained the consumption of cotton in the United States will, for the first time, exceed the yield of the country's cotton harvest. Under the influence of the increased demand, the price of cotton has gone up from 15.2 cents per lb in June 1941 to 20.9 cents in April 1942.

Increased industrial output in 1941 required greater imports of raw materials and, since shipping facilities became less freely available, the stage was set for an upward movement in import prices. After the Japanese successes in the Pacific, some sudden shortages made themselves felt; indeed, Philippine sugar had provided 16 per cent. of normal consumption, and Far Eastern rubber 98 per cent. of the pre-war supply.

Hourly wage rates in manufacturing industries rose by 15 per cent. in 1941 and continued to advance, though at a slower rate, in the opening months of 1942. A much-debated question has been whether the extra payment of 50 per cent. above the normal rate for overtime (i. e. for more than 40 hours a week) and double pay for Sunday and holiday work should continue even during the emergency. The trade unions have voluntarily renounced their right to the payment of double time for Sundays and holidays.

The real volume of consumption (i. e. that calculated in stable prices) reached an all-time record in the summer of 1941; in the first quarter of 1942 the volume of retail sales of goods other than automobiles was still at least as large as the average for the previous year, the distributing trade drawing upon stocks previously accumulated. Few commodities have been rationed; but civilian production, especially of durable consumer goods, has been cut down; and measures have been taken through the Federal Reserve system to reduce the volume of consumer credit for instalment buying. An enquiry has shown that nearly three-fifths of the total sales of durable consumer goods have been on an instalment basis. From a maximum of $6 milliard in 1941, the consumer instalment debt fell by nearly a milliard and a quarter up to March 1942. Probably two-thirds of this decline represented a liquidation of automobile instalment paper, due to the restrictions on production and sales of automobiles rather than to the consumer-credit regulation.

From the outbreak of the war to the end of 1941, wholesale prices in Canada rose by 28 per cent. and the cost of living by 15 per cent. The most notable difference in comparison with the United States is that in Canada the rise in the prices of farm products had until then been limited to 20 per cent., while in the United States it had attained 45 per cent. In November 1941 a new system of price control was introduced in Canada. Comprehensive price ceilings were established, maximum prices being defined as the highest price at which a person or firm sold or supplied goods or services of the same kind and quality during the period 15th September to 11th October 1941. The order establishing the price control provided for certain exemptions from the operation of the ceilings, inter alia in respect of goods sold for export. (Over a wide field, prices of goods handled in foreign trade have, however, been fixed in agreements concluded with the United Kingdom and the United States.) Authority is, moreover, given to the Wartime Prices and Trade Board to vary any maximum price, to prescribe other or additional conditions and terms of sale, and to exempt any person or goods from the regulations. Particular care has been taken, in the application of the price control, to prevent retail prices from rising.

Unlike prices, wages have not been subject to ceilings; workers have received bonus payments adjusted to changes in the cost of living, stabilisation of retail prices thus leading to stable wages. It has been found in Canada, as elsewhere, that the introduction of a comprehensive price stop makes it necessary for the government to assume more fully the task of directing economic life; as the chief Price Controller has pointed out, the main thing is to bring the entire national production under sufficient control to enable rapid adjustments to be made, rather than to adhere slavishly to a rigid plan.

In Canada, the yield of the wheat harvest in 1941 at 303 million bushels was much below the result of the previous harvest (551 million bushels) and somewhat below the average of the five preceding years. In accordance with a programme announced by the government, the Canadian farmers had reduced the area sown with wheat by about 22 per cent. and, in addition, weather conditions proved to be, on the whole, unfavourable. In the United States also, the area sown with wheat was kept small, being one of the most restricted for the last twenty years. But weather conditions were unusually good and the production amounted to 946 million bushels, which is one of the highest yields since the record harvest in 1915 (1,009 million bushels). For four successive years, North America as a whole has had a wheat production decidedly above the average. Since this has happened at a time of diminishing possibilities of export, the result has been that heavy stocks have accumulated in Canadian and American storehouses; these stocks are calculated to have amounted to 835 million bushels at the beginning of August 1941, compared with a "normal" carry-over of 175 million in 1938, and it is estimated that at the beginning of August 1942 the stocks will rise above 1,000 million bushels. Moreover, some stocks had been accumulating also in the Argentine and Australia. It has been calculated that in the four main wheat-exporting countries, the carry-over at the beginning of August 1942 will have risen to 1,340 million bushels and that, after deduction of 305 million bushels for normal national reserves, there will be an exportable net surplus of about 1,035 million bushels. This may be compared with the fact that, in the five years which preceded the present war, world exports of wheat oscillated between 500 and 620 million bushels.

Of maize, too, surplus stocks have been accumulating, especially owing to the coincidence in 1941-42 of exceptionally good crops in the two main producing countries: the United States and the Argentine, which with a production of over 3,000 million bushels accounted for about five-eighths of the world output of maize. The stocks available for export from the Argentine were reported as amounting to about 280 million bushels at the beginning of May 1942. There is not in the country sufficient storage room for an increase in stocks and, besides, maize cannot well be stored for long periods; the government has taken steps to dispose of maize at a low price, to be used as fuel, and it is also stimulating an extension of mixed farming to reduce the area devoted to the production of maize, wheat and linseed, of which there is a surplus, and to increase to some extent the use of maize (by an increase, e. g., in the number of pigs).

Price movements in various Latin American countries.

Percentage price increase (or decrease) during:	1939	1940		1941		June 1939 to Dec. 1941
	2nd half	1st half	2nd half	1st half	2nd half	
Argentine:						
Wholesale prices	+ 18	+ 2	0	+ 12	+ 22	+ 64
Cost of living	+ 5	— 2	— 3	+ 4	+ 7	+ 11
Bolivia:						
Cost of living	+ 38 (1)	+ 3 (2)	+ 11	+ 18	+ 15	+115
Brazil:						
Cost of living	+ 2	+ 2	+ 5	+ 7	+ 5	+ 22
Chile:						
Wholesale prices	+ 7	+ 4	0	+ 11	+ 19 (3)	+ 48 (4)
Cost of living	+ 5	+ 9	+ 1	+ 11	+ 10 (3)	+ 40 (4)
Colombia:						
Cost of living	— 2	+ 2	— 7	+ 6	— 3	— 5
Costa Rica:						
Wholesale prices	— 1	— 6	— 1	+ 8	+ 10	+ 11
Cost of living	— 2	— 2	0	+ 4	+ 5	+ 5
Mexico:						
Wholesale prices	— 1	+ 2	— 2	+ 8	+ 4	+ 11
Cost of living	+ 1	+ 1	0	+ 2	+ 13	+ 17
Peru:						
Wholesale prices	+ 11	+ 4	+ 5	+ 9	+ 16	+ 54
Cost of living	+ 4	+ 4	+ 5	+ 3	+ 8	+ 25
Uruguay:						
Cost of living	+ 4	+ 2	+ 1	0	— 2	+ 4
Venezuela:						
Wholesale prices	— 3	+ 3	+ 3	+ 5	— 2	+ 5
Cost of living	— 7 (1)	+ 5 (2)	+ 2	— 7	+ 1	— 6

(1) June 1939–January 1940.
(2) January 1940–June 1940.
(3) June 1941–October 1941.
(4) June 1939–October 1941.

The extent to which the Argentine, on account of its geographical position, has been affected by the war in general and shipping difficulties in particular may be gathered from the price developments of different groups of commodities.

Argentine:
movements of wholesale prices.

Indexes on base 1926 = 100	Agri-cultural products	Non-agri-cultural products	General price level
1939 August . . .	79	109	103
December . .	94	129	122
1940 December . .	73	138	124
1941 December . .	80	194	170

Agricultural products are mainly home-produced, while non-agricultural products (or the machinery and materials for their manufacture) are mostly imported. Low when the war started, the prices of agricultural products had a short-lived boom in the autumn of 1939, dropping in the course of the following year to 16 per cent. below the peacetime level, which they had barely regained by the end of 1941. The government has intervened in various ways in order to give support to agricultural producers. Minimum prices have been fixed for wheat, maize and linseed and the government is buying up at least a part of the surplus crops, seeking at the same time to restrict the areas sown. The higher prices which have to be paid for imported products have had an influence on the quotations of many articles produced in the Argentine, but steps have been taken to counteract the increase in prices — among others, in the textile trade.

Brazil, being closer to its main export markets and having a production more complementary to that of the United States, has not had to cope with the same marked divergence between import and export prices as the Argentine. The coffee price has been sustained by increased demand from the United States. No index of the movements of wholesale prices is available; the cost-of-living index shows an increase of 22 per cent. from June 1939 to the end of 1941. The steep rise in prices in Bolivia in 1939 was not connected with the outbreak of the war but with domestic difficulties (budget deficits, etc.).

In general, all the Latin American countries have been affected by a rise in prices of imported goods. The cost of living is often predominantly determined by locally-produced commodities; and some of the countries (Colombia and Venezuela) show a lower index figure for the cost of living at the end of 1941 than in the summer of 1939.

After the outbreak of the war in 1939, a wave of speculation lifted prices in India, within a few months, by more than 30 per cent. This abrupt advance was followed by a prompt decline, continuing to the middle of 1940. A steady rise then set in, affecting foodstuffs as well as materials for industry. Official price control has been established but has to contend with great difficulties in a country of India's size and population. The intensification of the war effort in Australia since December 1941 has led to a series of new measures regulating the country's economy. Prices of goods and services and

Price movements: India, Australia and New Zealand.

Percentage price increase during:	1939 2nd half	1940 1st half	1940 2nd half	1941 1st half	1941 2nd half	June 1939 to Dec. 1941
India:						
Wholesale prices	+ 36	— 17	+ 5	+ 14	+ 12	+ 52
Cost of living	+ 9	— 2	+ 4	+ 6	+ 3 (1)	+ 21 (2)
Australia:						
Wholesale prices	+ 5	+ 7	+ 1	0	+ 5	+ 20
Cost of living	+ 1	+ 1	+ 3	+ 2	+ 3	+ 12
New Zealand:						
Wholesale prices	+ 5	+ 7	+ 7	+ 3	+ 5	+ 30
Cost of living	+ 4	+ 1	+ 3	+ 2	+ 3	+ 12

(1) June 1941–November 1941. (2) June 1939–November 1941.

wages were stabilised at the level prevailing on 15th April 1942, provision being made, however, for equitable wage-adjustments and for price rises justified by higher import costs. Absence from work without good reason is prohibited (which rules out strikes); and changes in employment require a special permit. In New Zealand, control of foreign trade and minimum wages with compulsory arbitration in labour disputes were established before the war. At the beginning of the war price control was introduced, stipulating that no goods might be sold for prices higher than those charged for similar goods on 1st September 1939 (except with the express permission of the competent authorities). With the advance in the cost of living, several increases have been made in the minimum rates of wages: from 1939 to December 1941 the index of minimum rates for male workers rose by 6 per cent., while the index of retail prices increased by 11 per cent. In many instances, however, wages have risen more than the increase in the minimum rates, and weekly earnings have gone up as a result of a longer working week — up to 54 hours for defence work, instead of the 40-hour week in force for a wide range of industries before the war.

Price movements in the Far East.

Percentage price increase during:	1939 2nd half	1940 1st half	1940 2nd half	1941 1st half	1941 2nd half	June 1939 to Dec. 1941
China (Shanghai):						
Wholesale prices	+ 86	+ 42	+ 16	+ 46	+ 28 (1)	+ 471 (2)
Cost of living	+ 77	+ 33	+ 33	+ 39	+ 31 (1)	+ 470 (2)
Japan:						
Wholesale prices	+ 17	— 2	+ 1	+ 6	+ 5	+ 29
Cost of living	+ 9	+ 9	— 1	+ 1	+ 1	+ 21

(1) June 1941–September 1941. (2) June 1939–September 1941.

The latest index figures available for Shanghai refer to September 1941, when wholesale prices had risen by 470 per cent. since July 1939, reflecting, in the main, inflationary issues of paper currency. In Tientsin (the capital of the four provinces occupied by Japan in North China), a rapid rise in prices by about 50 per cent. from September 1939 to September 1940 seems to have been checked in the following twelve months, when the increase was only 13 per cent., a strict price control having been imposed by the military authorities.

From June 1939 to the end of 1941 the level of wholesale prices in Japan rose by 29 per cent., about one-half of this increase occurring in the last four months of 1939, when the yen depreciated by 14 per cent. (following the movement of sterling) and when for other reasons also (higher transport costs, etc.) prices of imported goods advanced. The figures in the following table show the level of prices at certain crucial dates since the beginning of the Sino-Japanese conflict in July 1937.

Japanese Wholesale Prices.

1929 (average)	100
1937 July.	109
October.	108
1938 September . . .	115
1939 September . . .	131
1940 August	139
1941 December . . .	158
1942 April	161

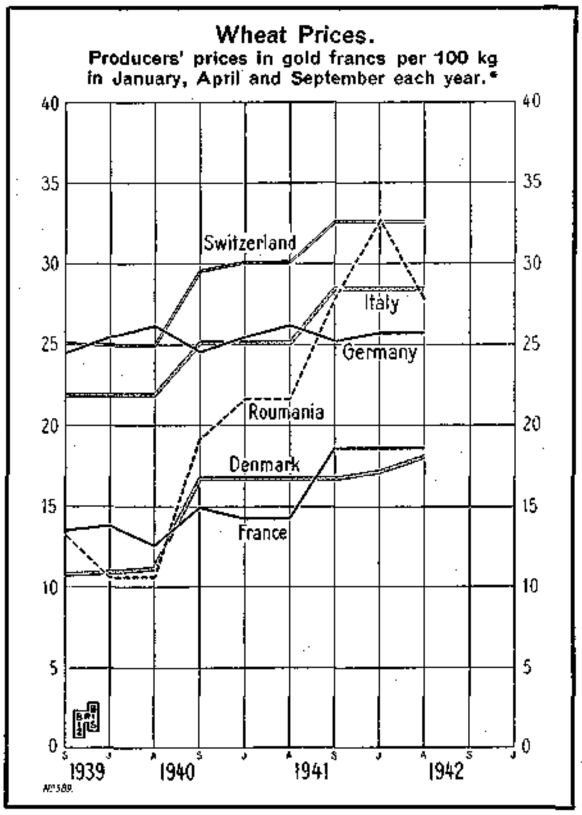
A note of warning to the public with regard to the danger of a continued upward movement of prices was sounded by the government in October 1937. In September of the following year, a decree made it obligatory for all shop-keepers to set out in a notice to the public the prices which they charged for their goods. In these ways the government tried to exert moral pressure instead of having recourse to coercive intervention. So far, the rise in prices had reflected Japanese developments, the price movements on the world markets remaining, on the whole, within comparatively narrow limits. When, after the outbreak of war in Europe, the rise in prices became more precipitous, supplies from abroad being, moreover, increasingly difficult to obtain, the government decided to introduce a system of official price control, according to which the prices of certain important classes of commodities were to be held at the level prevailing on 18th September 1939. Continued expansion of the volume of purchasing power in the hands of the public led, however, to substantial increases in the prices of commodities not subject to control and, in order to react against these tendencies, the government decided in August 1940 to prohibit all production of luxury articles (especially in the textile trade) and to extend the price control to all categories of food. Though the shrinkage in foreign trade, accentuated by the freezing of Japanese assets in the United States and then by Japan's entry into the war, affected the supply of a number of commodities on the Japanese market, in some ways it facilitated the task of the control, in that foreign influences on the price level were more or less eliminated and, in addition, the public necessarily came to understand the absolute need of economising for the sake of the war. According to official statements, the price control will continue to be applied with a certain elasticity, so as not to impede an expansion of production. Adjustment of prices is in the hands of a committee composed of certain members of the government and civilian experts, working in close contact with various associations in industry and trade.

The gradual elimination of external influences on the domestic price level and the reinforcement of the price control, which characterised developments in Japan, are the outcome of tendencies which, with variations in detail, are found all over the world. In the first stages of the war, a number of factors came into operation which exerted an influence more or less general in character. Notable among these factors were increased costs of transport, especially by sea, the interruption of the normal currents of trade by the blockade and counter-blockade (with effects both in Europe and in overseas countries, where surplus stocks accumulated), the depreciation of the currencies of the sterling area by 14 per cent., and the adjustment of prices on the continent of Europe to the German price level. Some of these factors are still at work; others have, so to say, spent their force: adjustment of prices to the new exchange value of sterling has already been completed, and so has adjustment to the German price level. Instead of these processes which embraced many countries, the decisive influence is now increasingly exercised by domestic conditions in individual countries, especially the extent to which governments are able to reduce private spending and thus absorb purchasing power, to make room for the tremendous military outlay of a total war. The success with which these tasks are handled is not the same everywhere; and the consequence is a diversity of developments, reflected in the movements of prices shown in the indexes published for the various countries. This does not mean, however, that no similarity is to be found. Since the problems with which the nations have to cope are, in their essence, identical, it is not surprising to find that, in many respects, very much the same measures are taken, with largely similar results.

The reduced influence of foreign factors has made each country more the master of its own fate in the realm of prices; and this greater independence has been used in many places to put a more effective brake on the upward surge of the cost and price structure. Hence a slowing-down of the price increases in a great number of countries from the middle of 1941. Experience has shown that price control, to be effective, must not be piecemeal: in particular, attention must be given to costs, i. e. the remuneration paid to the different factors of production. That means that governments must occupy themselves with difficult questions of profits and wages. Although it is impossible to escape a general reduction in the standard of living, governments find themselves forced to provide, by rationing and by some compensation for the increase in the cost of living, that intolerable hardships are avoided and the burdens equitably distributed.

The cost of living has been rising for many reasons. One factor recurring in a great number of countries is concern about the daily bread, leading to an increase in agricultural prices in order to stimulate output. Farmers themselves, after years of depression, have seen an opportunity to obtain a higher remuneration for their efforts and have, in the emergency, been able to exert an influence of considerable weight.

With the exception of Germany, where the wheat price had already been raised before the war, substantial increases have been made. Since higher prices have been fixed for other agricultural products also, the result is that, notwithstanding government subsidies, the group "foodstuffs" in the



* As given in the International Revue of Agriculture (May 1942).

cost-of-living indexes is generally one which registers a marked increase — sometimes even the highest increase of all. Other groups which often show a particularly high increase are "clothing" and "fuel". In these cases the rise in price is usually connected with reduced imports, for instance, of cotton, wool and petrol from overseas or coal from the European suppliers.

There is one group in the cost-of-living indexes which, uniformly for almost all countries, shows very little change: practically everywhere rents have been prevented from rising. In one or two countries they have even been lowered, since cheaper mortgage rates are considered to have diminished the cost for the owners, who have been ordered to pass on the benefit to their tenants. At the same time, building activity for private purposes has been severely cut down — in some countries even prohibited. There is no room in a total war for private investments unconnected with the armament programme. As a result, an abnormal scarcity of housing accommodation is beginning to make itself felt and will presumably become increasingly acute the longer the war lasts.

A result of all this fixing of prices — some high, some low — will certainly be that at the end of the war the cost and price structure will show a pattern little suited to peacetime requirements. It will certainly not be easy to rectify the many dislocations which will then appear; the adjustments that become necessary will only too often entail an immediate disadvantage for some sections of the community. Still, there can be little doubt that the restoration of a fundamental balance in the cost and price structure is a necessary condition for a healthy expansion in production; and such a balance is just as much needed when the state concerns itself actively with the management of economic affairs. Efforts will no doubt be made to prevent a deflationary drop in prices after the war; but a greater stability in the general price level must not be taken to mean that substantial adjustments in relative prices may be avoided.

III. PRODUCTION AND MOVEMENTS OF GOLD.

Statistics of production and movements of gold are less complete than in past years but the available data still permit the main facts of the gold situation to be indicated with some accuracy. In two respects the year 1941 shows a marked change in relation to the tendencies prevailing in the preceding years.

For the first time since 1929 gold production has remained practically stationary, amounting to about 41 million ounces in 1941, the continued increase — though at a slower rate — in South African production offsetting declines in other producing areas. In 1940 output was still rising by 4½ per cent. above that of the previous year and the average increase for the period 1930 to 1940 was at the rate of 7 per cent. per annum. Higher working costs and other effects of the war have now begun to make themselves felt and it is likely that world gold production in the next few years will decline rather than rise. In weight, current production is, however, more than twice as great as it was in the late 'twenties and in terms of currencies, devalued in the meantime, still greater, so that even with a gradual fall in production the supply of new gold will still be abundant, measured by earlier standards.

For the first time since 1934 the United States did not absorb the whole current output of gold in 1941. Of the new gold produced in that year, amounting to approximately $1,435 million, only one-half, $742 million, went into the monetary gold stock of the United States. This development is in marked contrast with the previous year, when the gold reserves of the United States rose by $4,351 million, i. e. by three times as much as the current gold production. The change is partly due to shipping difficulties and other interferences with trade, partly to the exhaustion of some of the reserves from which gold had been sold to the United States and, finally, to conversion of dollar holdings into earmarked gold by certain central banks. There is every reason to believe that, at least for the time being, the massive transfers of gold to the United States out of the reserves of other countries have come to an end and that, indeed, the acquisitions of gold by the U. S. Treasury will be limited to a part of the current gold production.

It is not possible to indicate fully from the published data the destination of that part of the current gold production — approximately $700 million — which was not taken by the United States in 1941. Switzerland, Sweden, Portugal and Roumania, South Africa and the Dutch East Indies, as well as certain Latin American countries (including Brazil, Venezuela and Uruguay), showed an aggregate increase of about $400 million in their reported gold holdings. As to the remainder, it is probable that the monetary authorities in the U. S. S. R., Japan and some other producing areas acquired the major part of the local output. South Africa, Australia, Canada, Mexico and other gold-producing countries continued to export gold. Transfers of gold were also effected by other countries for the settlement of foreign liabilities; but the possibility of using gold as a medium of payment was increasingly impeded by blockade, freezing of foreign-owned assets and the difficulty of physical shipments. Exchange holdings are as a rule subject to the same legal restrictions as gold; as between currencies and gold, however, there has been a tendency to regard the latter as the preferable asset for inclusion in monetary reserves.

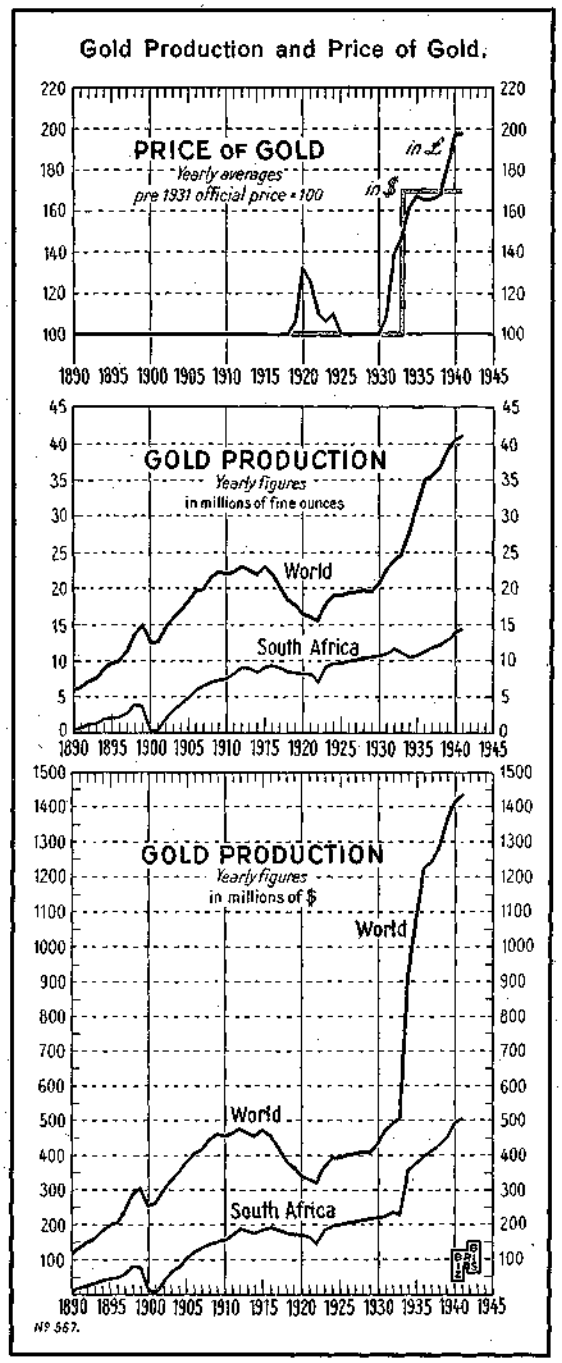
1. THE SUPPLY OF GOLD.

The following table shows the output of gold in the main producing areas and in the world as a whole.

World Gold Production	1929	1932	1939	1940	1941
	In thousands of fine ounces				
Union of South Africa	10,412	11,559	12,822	14,047	14,405
United States (1)	2,208	2,449	5,611	5,920	5,982
Canada	1,928	3,044	5,095	5,311	5,328
U. S. S. R. (2)	707	1,938	4,500	4,000	*
Australia	426	710	1,636	1,653	1,475
Korea	138	276	975	1,025 (2)	*
Japan	335	402	850	925 (2)	*
British West Africa	208	293	840	930	940
Mexico	652	584	844	883	860
Rhodesia	562	581	800	830	794
Colombia	48	248	570	632	655
Belgian Congo	173	243	517	517	*
Peru	121	86	272	288	300
British India	364	330	318	290	284
Chile	26	38	325	341	266
New Guinea	(3)	(3)	246	275	240
New Zealand	120	166	179	179	197
Sweden	(3)	132	230	209	191
Other countries	764	1,175	2,357	2,445 (2)	*
Total World Production	19,192	24,254	38,987	40,700 (2)	41,000 (2)
	In millions of dollars (4)				
Value of Total World Production	672	849	1,364	1,425	1,435

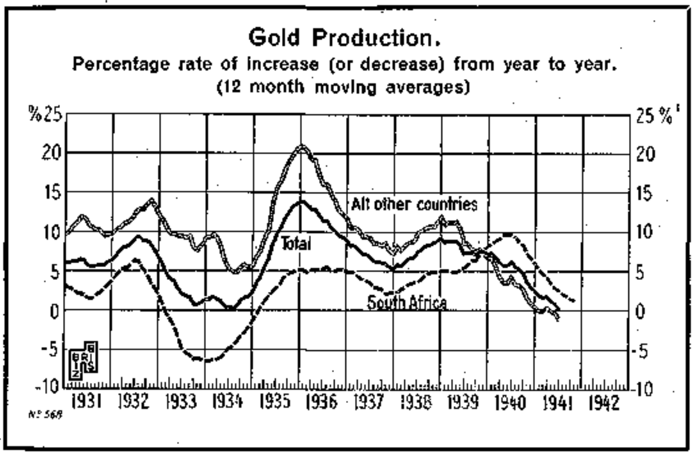
(1) Includes Philippines. (2) Estimates. (3) Included in other countries.
(4) Dollars of present-day value equivalent to $35 per ounce of fine gold. * Not available.

For the U. S. S. R. no information is available of the gold output in 1941 but it is believed that this output was not as yet much affected by the war, in view of the great distance of the producing areas from actual hostilities and the character of the gold production (carried on mostly by comparatively small groups of workers scattered over large areas). Figures are also lacking for the Japanese Empire and Manchukuo, but there again the extension of the war (in December) cannot greatly have affected the output in 1941. Just before war began in the Pacific, a gold shipment of $1.8 million arrived in the United States from the Philippines, bringing the total for the year up to over $40 million or rather more than in the previous year. Although the estimate of total world gold production in 1941 is partly based on incomplete information, it is probably sufficiently correct to permit the conclusion that in that year the upward movement in the current supply of new gold, which had begun in 1930, came to an end. Thus a brief retrospective analysis of the world's gold supply is particularly opportune at the present time.



The first of this set of three graphs gives the price of gold in dollars and sterling as a percentage of the pre-1931 parities and shows the considerable increase in the gold price in these two currencies over the last eleven years. The second graph gives the gold-production figures, in ounces, for the world (including the U. S. S. R.) and for South Africa separately since 1890. The third graph is a combination of the first two (the volume multiplied by the price) and gives the value in current dollars. Incidentally, it shows that the dollar value of the world production is now more than three times as large as in the years 1925 to 1929.

The slowing-down of the world output of gold from 1915 was due to the rise in costs and commodity prices brought about by the war of 1914–18. After a recovery in the years 1922 to 1924, production remained almost stationary from 1925 to 1929; that was the "gold scarcity" period, when steps were taken to economise the use of gold by lowering cover percentages and extending the gold exchange standard. In 1930, under the influence of falling costs and commodity prices, production rose, the price of gold remaining stable, while purchases by central banks ensured its marketing. The depreciation of sterling in the autumn of 1931, when the gold price in London increased



by some 40 per cent., gave a further stimulus to production, which in 1932 rose at the high rate of 9 per cent. per annum for the world as a whole. The South African pound was, however, kept at its old parity up to the end of 1932, and in that country the gold output actually declined in the following year; gold mining in the Transvaal requires a great outlay of capital and there is a time lag before new mines become productive. The large increase in gold production began in the autumn of 1934 after the fall of the dollar, the profitability of production being increased through a further rise in the price of gold. The rate of increase of world production reached its highest level in 1936 at 12 per cent. per annum; in South Africa it was only 5 per cent., but elsewhere the rise was much greater. In the following two years, which comprise the short-lived business boom of 1936–37, the rate of increase fell off again, to recover somewhat in the depression of 1938.

The above graph shows, on a monthly basis, the percentage rate of increase (or decrease) from year to year of the world gold production (excluding the U. S. S. R.) and thus illustrates in a sensitive way the trend of gold production by volume (in value the increases after 1931 would, of course, have been much greater). The following table gives yearly figures illustrating the same theme.

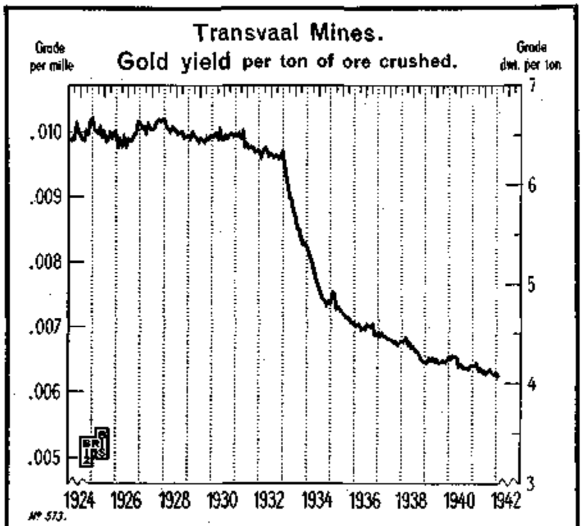
Annual rate of change in Gold Production 1927–1941.

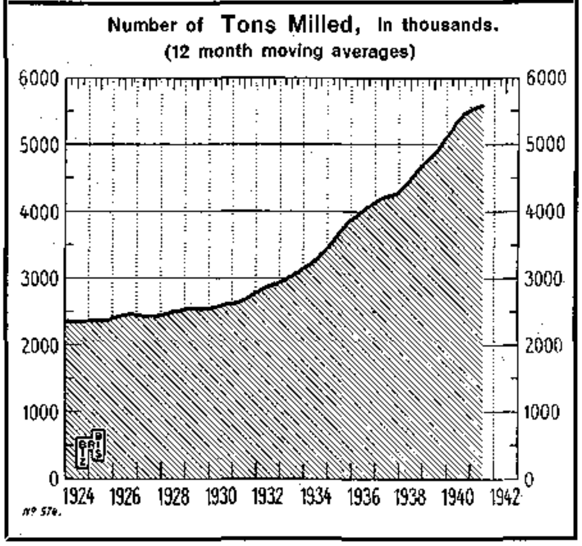
In percentages	Transvaal	U. S. A.	Canada	All others	World production (excluding U. S. S. R.)	U.S.S.R.	World production (including U. S. S. R.)
1927	2	— 6	6	— 3	0	— 9	0
1928	2	2	2	— 5	1	—44	— 1
1929	1	— 1	2	0	0	83	2
1930	3	3	9	10	5	112	9
1931	2	5	28	7	6	10	7
1932	6	2	13	12	8	17	9
1933	— 5	4	— 3	20	2	39	5
1934	— 5	21	1	7	2	43	6
1935	3	17	11	9	7	17	9
1936	5	21	14	12	11	17	12
1937	4	10	9	11	8	— 5	5
1938	4	6	15	12	8	0	7
1939	5	10	8	7	7	—10	5
1940	10	6	4	4	6	—11	4
1941	2	1	0	(1)	1 (2)	(1)	1 (2)

(1) Not available. (2) Estimates.

The developments from the beginning of 1939 are of particular interest, since, for the world as a whole, the rate of increase in gold production then began definitely to fall. Until the middle of 1940 this was solely due to the decline in the rate of increase in "other" areas (Australian production actually fell off from the spring of 1940); South African production, on the other hand, continued to rise and found its highest point in the middle of 1940 at 10 per cent. per annum; the previous lowering of the grade of ore came to a halt, while more ore was crushed. From the middle of 1940 the rate of increase was falling everywhere and in the course of 1941 world gold production probably began to decline.

In South Africa the rise in the price of gold, after the depreciation of the South African pound at the end of 1932, had made it possible to reduce the grade of ore crushed and in that way to lengthen the life of the mines.

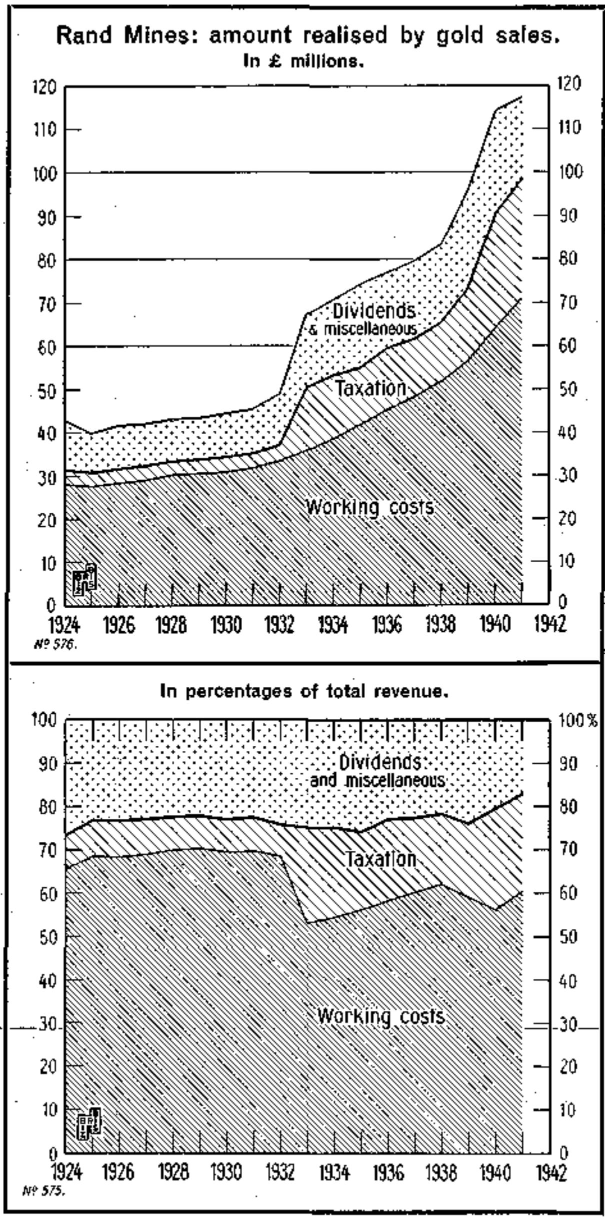




The reduction in the grade of ore crushed was at its greatest in 1933–34; it has since then been slowed up, coming to a temporary halt in 1939 but continuing again in 1940 and 1941. The quantity of ore crushed has increased regularly, with a further advance from 64.5 million tons in 1940 to 67.3 million in 1941. While the gold industry has given up some of its European employees to war service, the number of natives employed increased from 346,726 at the end of 1940 to 352,416 at the end of 1941, as a result of increased recruiting from territories in the tropical zone north of 22 degrees South, and of improved health conditions of the natives employed at the mines.

The graphs on the next page show the gross receipts from the sale of gold and their distribution between working costs, taxation and dividends, plus some minor miscellaneous items.

The increase in working costs up to 1939 was almost solely due to the reduction in



the grade of ore crushed, but since the war began costs of materials and of salaries and wages (including payments in kind) have risen. Taxation also has been increased. The figures for taxation used in the graph include the so-called "levy" of 6s. 2d. per ounce resulting from the fact that in 1939 producers were only paid 149s. 2d. (i. e. 150s. less realisation charges) instead of the market price, which then averaged 155s. 4d. In the following year this levy was abolished, the producers being paid 168s. (less realisation charges); but at the same time the "special war contribution", which is assessed on net gold-mining revenue (but before deduction of the legal allowances for amortisation and for losses brought forward), was raised from 11 to 16 per cent. as from January 1941 (and it was again raised to 20 per cent. as from January 1942). Taxation absorbs more than one-half of net revenue, taking about 23 per cent. of the gross receipts from the sale of gold and leaving about 16 per cent. for dividends. While the so-called "levy", which reduced the price paid for gold coming from the mines, adversely affected the profitability of gold production and incidentally tended to prevent a further lowering of the grade of ore crushed, a tax on net profits is less likely to restrict the working of mines already opened but will, if high, discourage the investment of fresh capital in new mining ventures. South Africa has valuable deposits of chrome and manganese ore which, if they were more extensively mined, would widen the basis of the country's economy.

On 18th March 1942, the South African Minister of Mines stated that since the outbreak of war the Union Government had decided not to encourage the opening of new gold mines outside the Witwatersrand area, but rather to finance fresh base-mineral mines. The government's policy was to maintain the production of gold at its present level, since the whole economic life and taxation policy of the country depended on the gold output, which also enabled the government to finance the import of commodities essential to all industries and to maintain the exceptionally sound financial position which South Africa enjoyed. In an earlier statement the Minister had said that curtailment of gold production was not necessary for the expanded production of war metals.

As a matter of fact a substantial decline in development works was announced in the Rand gold-mining reports for the first quarter of 1942. This reflects the necessity of economising steel and other supplies required for direct use in the war effort. The curtailment is greatest in those producing mines which have already sufficient ore reserves to supply the mills for several years, and it need not, therefore, entail any material reduction in gold output.

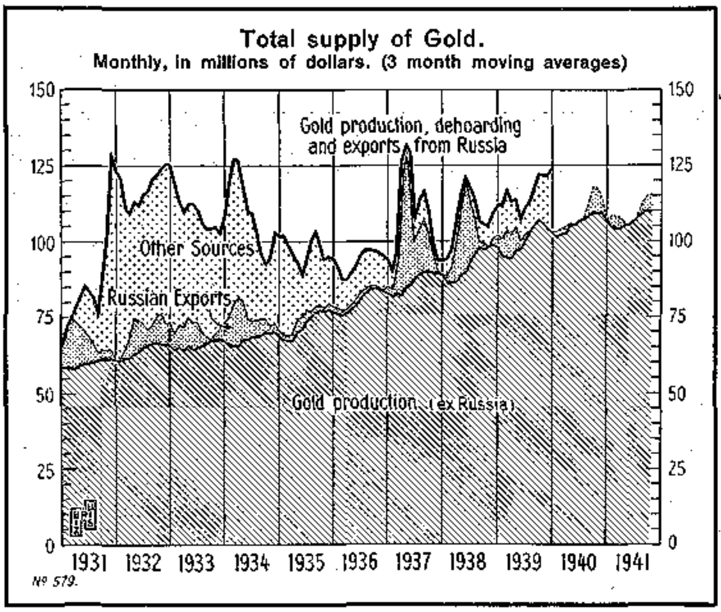
If the Philippines be excluded, there was a slight decline in the gold output of the United States — the first for twelve years — which reflects the concentration of mining on the extraction of metals needed in war production. In Canada, a setback in the important Kirkland Lake District was fully compensated by higher output in other areas; a peculiarity of the Canadian production is that much gold is won as a by-product from the mining of other metals (copper, lead and zinc) now extracted in record amounts on account of their importance for the war effort. In Australia, on the other hand, gold production fell by 11 per cent. as a direct result of a lack of men and material brought on by the war. In a number of other areas the influence of the war has also made itself felt: it is, for instance, reported from Southern Rhodesia that production there has been hampered by a shortage of explosives.

The spectacular growth in the world's output of gold since 1929 has some relation to the shift in the importance of the sources from which the gold has been derived. The proportion of gold obtained from alluvial deposits fell steadily from the middle of the nineteenth century down to 1929, leaving the place of honour first to gold from quartz reefs and then to the South African gold procured from the banket or the "pudding-stone" of the Rand, which in 1929 supplied over one-half of the new gold. From 1930 gold from alluvial deposits (in the U. S. S. R. and elsewhere) at least partially recovered its importance, but these deposits are more easily exhausted than other sources; the slowing-down in the increase of world production from 1939 and the absolute decline in several areas during 1940 and 1941 are probably to some extent due to such exhaustion. As to the future of gold production, the failure of so many prophecies in the past enjoins extreme caution. But past experience shows that, apart from the discovery of new gold deposits, the relation between the gold price and working costs has a considerable influence on the supply in that it determines the profitability of gold production. In wartime, costs tend to rise, and these higher costs habitually remain to some extent after war conditions have passed. If the price of gold remains unchanged, gold production will become less profitable and decline, as happened after 1915. The high level of taxation also affects profitability; but when the war is over it may be possible to reduce taxation and in that way give a stimulus to gold production.

Some seemingly pessimistic predictions have recently been made with regard to the future output of gold in South Africa. In 1941 the consulting engineer of the Union Corporation produced a calculation according to which the yield of the mines at present in operation will fall from 1943, the decline being accelerated from 1950 onwards; but he points out that the fall in the tonnage of ore milled may prove smaller than his forecast, should the price of gold rise or the burden of taxation be appreciably reduced. If producers concentrate more on high-grade ores, the immediate output will be kept up but the life of the mines will be curtailed.

The supply of gold for monetary purposes does not, however, depend solely on the volume of current production. Other factors are also of importance. The following graph shows the origin of the supply of gold since 1931; it comprises (monthly, with a three-month moving average) (i) production excluding the U. S. S. R.; (ii) exports from the U. S. S. R. to the United States, the United Kingdom and Germany (since the war, to the United States *only*); and (iii) other sources (i. e. Indian and Chinese dishoarding, return of scrap, etc.).

The graph shows in particular the important contribution that was made by dishoarding from the East to the monetary gold supply of the Western world. The contrast is striking in comparison with the 'twenties, when the yearly drain of gold to India was at the rate of $80 million (i. e. $135 million at the new price of $35 per ounce), absorbing nearly one-fifth of the current production. In estimating the supply of gold which will be available for monetary purposes in the future, consideration must be given to the possibility of a recrudescence of hoarding in the East. Indeed, the movement to Eastern hoards may have already started; in Indian bazaars the demand for gold has recently been on the increase and the price paid for gold has risen.



In the 'thirties the net industrial consumption of gold was probably nil, gold recovered from scrap, coin, etc. being sufficient to meet in full the current demand from arts and industries. In this respect too, the contrast with the previous decade was marked; it was estimated that in the 'twenties the yearly industrial consumption absorbed about $100 million (i. e. about $170 million at $35 per ounce) of the current production (though this estimate may have been on the high side). Modern dentistry seems increasingly to prefer special compositions to gold; on the other hand, an increase in the demand for gold from jewellers, etc. may be expected with an improvement in business conditions.

The U. S. S. R. exports of gold were erratic all through the 'thirties. They were particularly large in 1937 at the time of the "gold scare", to which these exports partly contributed.

Account being taken of the supply from all the different sources, the annual addition to the monetary stock of gold in the 'thirties was relatively stable, the gradual decrease in the flow of gold from the East being offset by the increase in the current output.

2. MOVEMENTS OF GOLD.

The following graph shows the world production of gold (excluding the U. S. S. R.) for the years 1934 to 1941 and the monthly increase of the United States gold stock.

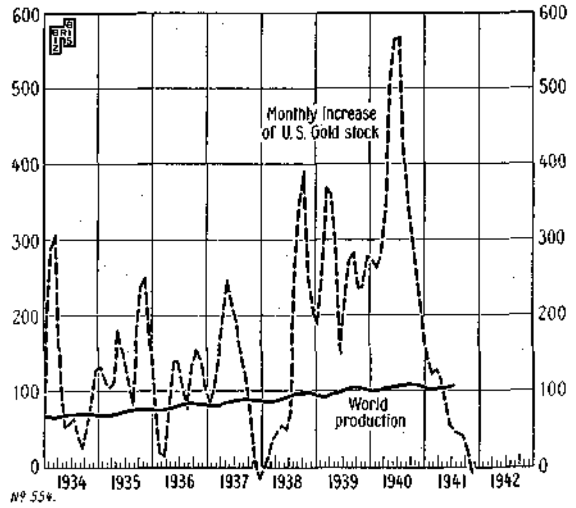
From 1934 to 1938 there were only three short periods when the United States gold imports fell below world production:

(i) In the early autumn of 1934, when for a few months there was a flow of funds to Europe, reflecting in part a certain uneasiness with regard to the monetary policy of the United States (caused by the adoption of the silver-purchase programme in August 1934) and partly a direct consequence of the silver purchases abroad through which foreign markets were provided with dollar balances.

(ii) Early in 1936, when European funds were withdrawn from New York under the influence of renewed uncertainty as to the course of American monetary policy, in connection with the voting of veterans' pensions and the extension of the President's power to devalue the dollar.

(iii) From the autumn of 1937 to the summer of 1938, under the double influence of a repatriation of funds to France (after the carrying-through of the Reynaud financial reforms) and of growing fears as to the maintenance of the gold value of the dollar (when the recession after the short-lived boom of 1936–37 increased in intensity).

World Gold Production
and the Increase of U.S. Gold Stock.
Monthly, in millions of dollars. (3 month moving averages)



From the autumn of 1938 movements of capital to the United States (necessitating shipments of gold) began largely to be determined by increasing tension over political developments in Europe. After the outbreak of war, increased purchases on the American market and the placing of contracts with American industry made it necessary — particularly for the British Government — to acquire dollars against sales of gold. (Canadian exports included gold from reserves belonging to the United Kingdom.)

In 1941 a new phase opened: available foreign resources being largely exhausted or frozen, U. S. imports of gold have become practically limited by the volume of production in those countries which are still able to arrange for transports to the United States. The following table shows the falling-off of U.S. imports, which amounted in 1941 to very little more than the current output of a few producing countries.

United States Gold Imports from different countries 1939–41.

In millions of dollars	Gold-producing countries						All others (1)	Total net imports (2)
	Canada	Philippines	Australia	Mexico and Colombia	South Africa	Total		
1939 monthly average	51	3	6	5	2	67	231	298
1940 " "	219	3	9	4	15	250	145	395
1941 January	47	3	11	4	150	215	19	234
February	82	3	7	1	0	93	16	109
March	96	4	6	3	3	112	7	119
April	20	4	5	4	132	165	7	172
May	16	3	4	4	4	31	4	35
June	18	2	5	1	0	26	5	31
July	19	5	5	3	0	32	5	37
August	11	5	7	3	0	26	11	37
September	43	3	2	3	4	55	11	66
October	16	3	6	3	0	28	12	40
November (3)	25	2	6	8	0	41	9	50

(1) Includes U. S. S. R. (see page 97). (2) Net to April 1941, gross from May 1941.
(3) Beginning 4th December 1941, the Department of Commerce suspended publication of gold import (and export) statistics.

At their peak in March 1938 the gold reserves of the United Kingdom totalled more than $4,000 million; by the outbreak of war they amounted to $2,038 million. On 1st September 1941, i. e. after two years of war, all but $151 million of this gold had been expended. In the same two years the

British Government, in addition, made use of dollar balances, market securities and various other investments to the extent of somewhat more than $1,000 million. For British purchases in America to continue, new facilities had necessarily to be procured. In March 1941 the Lend-Lease Act provided $7,000 million for the supply of effective material aid to those countries whose defence was considered vital to the defence of the United States, and a further provision of nearly $6,000 million was approved in October of the same year. After the United States had become involved in the war, the amount of lend-lease funds was increased to a total of

Reported Gold Reserves	End of 1939 (1)	End of 1940 (1)	Loss (—) or gain (+) during 1940	End of 1941 (1)	Loss (—) or gain (+) during 1941
	in millions of dollars (at $ 35 per fine ounce)				
Group 1: U. S. A. (2)	17,644	21,995	+ 4,351	22,737	+ 742
Switzerland	549	502	— 47	665	+ 163
Sweden	308	160	— 148	223	+ 63
Java	90	140	+ 50	200	+ 60
Roumania	152	157	+ 5	183	+ 26
Brazil	40	51	+ 11	73	+ 22
Uruguay	68	90 (3)	+ 22	102	+ 12
Venezuela (4)	52	29	— 23	41	+ 12
Turkey	29	88	+ 59	92	+ 4
Bohemia and Moravia	56	58	+ 2	61	+ 3
Argentina	466	353 (5)	— 113	354	+ 1
Peru	20	20	0	21	+ 1
Total	19,474	23,643	+ 4,169	24,752	+ 1,109
Group 2: Belgium (6)	714	734	+ 20	734	0
British India	274	274	0	274	0
Bulgaria	24	24	0	24	0
Chile	30	30	0	30	0
Egypt	55	52	— 3	52	0
France (7)	2,709	2,000	— 709	2,000	0
Germany	43	40	— 3	40	0
Hungary	24	24	0	24	0
Mexico	32	47	+ 15	47	0
New Zealand	23	23	0	23	0
Portugal	69	59	— 10	59	0
United Kingdom (8)	1	1	0	1	0
Total	3,998	3,308	— 690	3,308	0
Group 3: Colombia	21	17	— 4	16	— 1
Canada	214	7 (9)	— 207	5	— 2
South Africa	249	367	+ 118	362	— 5
Denmark	53	52	— 1	44	— 8
Netherlands	692	617	— 75	573	— 44
Total	1,229	1,060	— 169	1,000	— 60
Grand Total (10)	25,500	29,000	+ 3,500	30,000	+ 1,000

(1) Partly estimated.

(2) Not including gold held in Stabilization Fund: $156 million in December 1939, $48 million in December 1940, $24 million in September 1941 (latest data reported).

(3) Including certain reserves previously not reported.

(4) Beginning December 1940, figures refer to gold reserves of new Central Bank only.

(5) Since April 1940 figures on certain gold reserves no longer available.

(6) Not including $17 million gold held by the Treasury.

(7) Not including gold held in Exchange Stabilisation Fund, i. e. $477 million in May 1939 (latest data reported).

(8) In September 1939, $1,162 million was transferred from the Bank of England to the Exchange Equalisation Account. Latest data of gold held by the Exchange Equalisation Fund $1,732 million (March 1939).

(9) On May 1, 1940, gold belonging to the Bank of Canada was transferred to the Foreign Exchange Control Board. Gold reported since then is gold held by the Minister of Finance.

(10) Partly estimated and including also other countries (but not U. S. S. R. or Spain).

$48,000 million, and by March 1942 lend-lease agreements had been concluded with thirty-four countries. Under these facilities exports can be made from the United States independently of the amounts obtained through sales of gold to the U. S. Treasury or otherwise mobilised on the American market.

Since in 1941 the monetary gold stock of the United States absorbed only one-half of the current output, there remained nearly $700 million which flowed into the gold reserves of other countries. The table shows the reported changes in gold holdings of central banks and governments. Among the countries for which no reports are available, the U. S. S. R. and Japan are likely to have increased their reserves from the domestic output of gold. American statistics reveal that in the first eleven months of 1941 the U. S. S. R. exported gold to the United States up to an amount of $31 million, representing perhaps one-fifth of the country's current production. In 1940 the gold production in Japan and Korea was estimated at $68 million and for 1941 the only reported exports are $9 million to the United States.

Recent increases in the gold holdings of Switzerland and Sweden have been partly due to a net gain of monetary reserves and partly to conversion of foreign exchange into gold.

Monetary Reserves
of Switzerland and Sweden 1940–42.

End-of-month figures, in millions of national currency units	Gold	Foreign Exchange	Total
Switzerland (Sw.fcs)			
1940 December. . . .	2,173	997	3,170
1941 December. . . .	2,878	679	3,557
1942 March	3,394	183	3,577
Sweden (S.Kr.)			
1940 December. . . .	672	750	1,422
1941 December. . . .	938	760	1,698
1942 March	1,162	632	1,794

In the course of 1941 and the first quarter of 1942 the Swiss National Bank increased its gold holdings by Sw.fcs 1,220 million, Sw.fcs 410 million representing a net gain in the monetary reserves and Sw.fcs 810 million conversion of foreign exchange (i. e. dollars) into gold. In the bank's annual report for 1941 it is said that the freezing of dollar assets has practically put an end to transactions in that currency in Europe and that increased use has been made of gold instead of dollars for the settlement of debts in the balance of payments. It may be added that, at the prevailing low rates of interest paid on short-term investments in the American market, conversion of dollars into gold involves only a slight loss of revenue for the owner of the funds. The Sveriges Riksbank also acquired gold; from the beginning of 1941 to the end of March 1942 its gold stock increased by S.Kr. 490 million, S.Kr. 370 million representing a net gain in monetary reserves (of which S.Kr. 26 million came from domestic production) and S.Kr. 120 million resulting from conversions of foreign exchange into gold. A part of the gain in the monetary reserves of the Swiss National Bank and of the Sveriges Riksbank was due to purchases of dollar holdings from the commercial banks and the public in the two countries. Offers of dollars were especially large in the spring of 1941, i. e. just before the freezing measures in the United States

Swedish Balance of Payments, 1941	In millions of S.Kr.
Current account:	
Trade deficit	— 321
Income from shipping	+ 350-400
Interest and dividends	+ 75-100
Payment for ships sold, etc.	+ 120
Proceeds of sales of commodities previously stored abroad	+ 30
Amounts received as insurance, compensation for war damage, etc.	+ 100
Surplus on current account *	+ 390
Capital account:	
Purchase of securities abroad	— 40
Net shift in the clearing	— 130
Advance payments to Swedish exporters and credits granted by Swedish producers	— 170
Total export of capital	— 340
Balance	+ 50

* There was an estimated deficit of S.Kr. 300 million in 1940. As regards the balance for 1941, it may be pointed out that certain of the amounts booked as current income, e.g. insurance and compensation for war damage, correspond to capital losses suffered by the country.

were extended on 14th June 1941 to all countries on the continent of Europe. For Sweden an interesting attempt has been made to calculate the different items in the balance of payments for 1941.

In 1941 net acquisitions of gold and foreign exchange by the Sveriges Riksbank and the Swedish commercial banks amounted to S.Kr. 174 million; the difference between this figure and the above balance of S.Kr. 50 million is probably represented by repatriation of balances held abroad or liquidation of foreign investments by holders other than the commercial banks.

In Latin America the chief reserves are held by the Argentine, which has gold in addition to the $350 million shown separately by the central bank. It is reported that its aggregate holdings are larger than the combined reserves of the remaining Latin American countries. Thanks to an influx of funds and a surplus of exports in 1941, the Argentine Government has not availed itself of the financial assistance offered by the U. S. Stabilization Fund and Export-Import Bank, amounting to $110 million. Other Latin American countries have as a rule accepted such assistance and have thus been able to avoid shipments of gold to meet temporary difficulties created for them by war conditions. Increasing demand for goods by the United States has enabled several of these countries to build up an export surplus and thus to add to their monetary reserves: Brazil, Uruguay and Venezuela increased their reported gold holdings during 1941.

Surplus exports also enabled the gold holdings of the Dutch East Indies to be increased from $140 million at the end of 1940 to $200 million at the end of October 1941, despite the fact that part of the income earned by the export trade was used to meet the expenditure of the Dutch authorities in the United States and elsewhere.

Under an agreement announced in the spring of 1941, the Bank of England, acting on behalf of the British Treasury, undertook to pay 168s. per fine ounce for South African gold delivered in South Africa, the producers being given the full market price (less realisation charges of 1s. 10d. per ounce). The South African Reserve Bank acquired part of the new gold from the mines; but the vast bulk of the gold produced in South Africa has been sold to the British authorities, as may be seen from the increase of only £35 in the Reserve Bank's holding between the beginning of the war and the end of 1941, whereas the South African gold output over that period amounted to £275 million.

In the past, gold reserves provided a useful basis for the financing of rapidly rising government expenditure *in time of war*. But with the development of modern credit systems it has been possible to employ methods on the domestic markets which do not require the possession of metal reserves (not even, it would seem, to maintain confidence in the currency). In relation to foreign markets, however, gold has continued to serve as a reliable means of payment, being still universally accepted by monetary authorities at a more or less fixed price (in spite of the currency changes in the 'thirties).

During the war of 1914–18, the main belligerent countries all took steps to withdraw gold coin from circulation in order to strengthen their central reserves; but that did not suffice. The vast expenditure occasioned by the war and the growing need of imports made it necessary to find foreign means of payment in other ways than by gold shipments: foreign securities and other foreign investments were sold and credits were negotiated in foreign markets. In connection with the credit arrangements, gold still proved useful; a technique appeared to develop, by which gold was sent to foreign markets where credits were secured, in order to produce a high degree of liquidity in those markets. As the war proceeded, credit assistance between powers belonging to the same group increased in importance, eliminating settlements in gold. Further, it may be remembered that from February 1916 Sweden, a neutral country, refused to accept gold unconditionally in payment for exports of goods. This refusal was not due to any mistrust of gold (in fact, after the decision in 1916 the Sveriges Riksbank, up to the end of 1918, added S.Kr. 125 million to its gold reserves*) but had as its purpose to prevent an excessive influx of gold from causing an undue expansion in the domestic credit system, and also to provide the government with increased bargaining powers for the import of commodities. (Since the summer of 1941 the Swiss National Bank has similarly refused to accept all the U. S. dollars offered to it, being anxious, in particular, to prevent an undue expansion in the domestic credit volume.)

In the present war, gold has again been used on a large scale for foreign payments (especially to the United States) but once more it has been found that other resources are also required. Foreign assets have been mobilised and foreign credits have been arranged. For a number of reasons the forms now used differ from those employed in the last war. Private lending is now almost *nil*; facilities made available through the clearings, lend-lease aid and stabilisation loans all have in common the provision of credit through official

* The law of 8th February 1916 suspended the obligation of the Sveriges Riksbank to buy gold at a fixed price. Under the monetary union with Denmark and Norway, however, gold coins were still legal tender and Scandinavian gold coins (thus Danish and Norwegian also) could still be sent to Sweden, until in the course of 1916 it was agreed between the three Scandinavian countries to prohibit all exports of gold. Of the S.Kr. 125 million acquired by the Riksbank between 8th February 1916 and the end of 1918, S.Kr. 44 million represented Scandinavian gold coins and S.Kr. 81 million other gold coins. The more formal reasons given by the Riksbank in its message to the government dated 4th February 1916, containing the proposal to suspend the obligation to buy gold, laid stress on the fact that the Riksbank already had sufficient reserves and that the purchase of gold would be "uneconomic" since the exchange rates had moved strongly in favour of the Swedish crown; but in the discussions which led up to the proposal the more fundamental reasons set out in the text above were strongly emphasised.

agencies. Well-nigh the whole world being divided into two belligerent camps, a series of arrangements have been concluded which are designed to ensure that financial considerations shall not limit the aid given within each group. That being the case, gold movements have been relegated to a secondary place; indeed, the total amounts involved in the various arrangements for mutual assistance already attain figures which exceed the total value of the world's monetary gold reserves. Not money but the volume of production and the possibilities of transport set the limit for the movements of materials between allied countries.

In these circumstances, the question has been raised whether for the time being gold production serves a useful purpose. Would it not be preferable to divert the man-power and other resources now engaged in the production of gold to other tasks? To some extent such a diversion is brought about almost automatically by the mobilisation of men for military service, by increased costs of production and by the difficulty of obtaining machinery and other materials. It has been suggested that the price of gold be lowered in order to discourage gold production by rendering it less profitable; but the suggestion has not been adopted, on the grounds that such measures would disturb existing monetary arrangements, impair monetary confidence and upset the financial stability of certain of the gold-producing countries. In so far as it is considered desirable to curtail production (and the situation is not the same in all countries), the cut can be effected by more direct methods, such as restriction of the allocation of machinery and other supplies.

The assistance now rendered by various powers to each other is to facilitate the winning of the war. In the immediate post-war period also it may be found useful to continue some form of assistance since all countries will be interested in the re-establishment of orderly conditions and a speedy recovery of peacetime production and international trade. One of the tasks will be to provide for adequate monetary reserves to make it possible for the various countries at least to loosen, if not to discard, the straitjacket of restrictions and controls into which the trade of the world has been forced. The war will leave behind a dangerously high volume of purchasing power in the different markets and so many other maladjustments that a strong foreign reserve position will have to be built up before freedom of movement can be restored. To judge from pronouncements by authoritative persons in practically all countries, gold may be expected to retain its function as an appropriate medium for the settlement of balances on foreign account, and will thus continue to be held, together with foreign currencies, in reserve for such payments. Trade can never be made to balance from day to day; some elasticity is required; and the methods by which elasticity can be provided are not many. Every monetary system presupposes a certain discipline, and the kind of discipline required is very much the same whether or not gold is chosen as a basis. Dynamic forces within a monetary system are also needed; and the current increase in gold supply constituted, at least before 1914, an important dynamic element in the world's monetary and credit system.

The present maldistribution of gold (a result partly of American developments and partly of disturbed conditions in Europe over a number of years) will in many ways affect the monetary problems to be solved when the war is over. One possibility is that more or less clearly defined groups of countries will continue to carry on trade and foreign exchange relations on a clearing basis, although with such relaxations as peacetime conditions will allow. Gold would then presumably play a minor rôle — at least within the groups. There may, however, be another tendency, followed by a greater or smaller number of countries, towards a system of free exchange transactions supported by adequate reserves and with gold as the mainstay of these reserves. The successful establishment of such a system will depend upon the fulfilment of many different conditions — among them the availability of sufficient gold from current production or from already accumulated gold holdings. The task of reconstruction will then consist in the creation of a situation in which the different countries can replenish and retain their monetary reserves. Outside assistance by reconstruction loans or through stabilisation credits will no doubt be exceedingly useful in helping to fill a gap in budget accounts and balances of payments and to reconstitute monetary reserves more quickly than would be possible by purely national action. But such assistance will be a mere palliative, bringing temporary relief only while the borrowed funds last, unless steps are taken to secure in the various countries and in their relations with each other a fundamental balance in budgets, cost and price structures, exchange rates and international payments. In a number of countries there is unmistakably a growing insistence on the importance of "equilibrium", "balance" and "proper parities", and this tendency may be taken to signify a better understanding of the conditions that must be fulfilled for at least a moderate success to be achieved in the functioning of the world's economic and monetary systems. Trade depends so largely on monetary arrangements that little progress can be made in the exchange of commodities and the readaptation of production to peacetime needs without providing for an elastic and smoothly functioning monetary relationship between the different countries.

IV. INTERNATIONAL DEBTOR-CREDITOR RELATIONSHIPS.

The value of a creditor position on international account is of a two-fold nature: in the short run, the availability of reserves in an emergency and, in the long run, the income received in interest and dividends from abroad. The emergency of war thus provokes big shifts in the international debtor-creditor relationships of the belligerents, especially vis-à-vis their principal suppliers. This was true in 1914-18 and the same thing is happening again today.

Before 1914 there were three important international creditors — England, France and Germany — which held foreign investments of the following order of magnitude: England, $20,000 million; France, $9,000 million; and Germany, $6,200 million*. The creditor positions of England and France were impaired during the war, but they still remained substantial creditors, while Germany became a debtor. And in this war, too, big shifts in debtor-creditor relationships are taking place.

A net debtor on international account before 1914, the United States reached a position of equilibrium about two years after the outbreak of war, as foreign-owned dollar assets were drawn upon to pay for armament deliveries; from 1917 onwards large credits were granted to associated powers and by the end of the war the United States was a net creditor. As the largest exporter of capital in the 'twenties, the United States rapidly built up a creditor position of considerable strength; in 1929-30 the investments of the United States in foreign countries reached $15,000 million, offset to some extent by foreign investments in the United States, while on a nominal amount of war debts exceeding $10,000 million service was being paid. Then, in the 'thirties, the movement was reversed: funds streamed towards the United States, which, as the largest importer of capital, rapidly reduced its net creditor position and built up a mighty gold stock.

U.S. Net Creditor Position and Gold Stock.

At end of year in millions of dollars	Investments in foreign countries	Foreign investments in the United States	Net creditor position of United States *	U.S. gold stock	U.S. net holding of international resources
1934	13,530	5,620	7,910	8,240	16,150
1937	11,790	8,030	3,760	12,760	16,520
1938	11,760	8,700	3,060	14,510	17,570
1939	11,490	9,590	1,900	17,640	19,540
1940	11,180	9,690	1,490	21,990	23,480

* Exclusive of inter-governmental debts (war debts and the direct loans of the Export-Import Bank).

At the end of 1940 the net creditor position of the United States had been reduced to under $1,500 million, indeed to below $500 million if the market value of foreign securities be taken into account; and, again, about two

* These figures are based on those given in "The Problem of International Investment", pp. 113-131, issued in 1937 by the Royal Institute of International Affairs (London) and on the authorities quoted therein. Approximate conversions have been made into the gold dollars then current.

U. S. Foreign Balance of Interest and Dividends.

In millions of dollars	Income	Payments	Excess of income
1929	979	414	565
1934	493	126	367
1937	578	280	298
1938	549	196	353
1939	546	226	320
1940	525	195	330

years after the outbreak of war a position of equilibrium was probably reached. But on income account the United States largely conserved its benefits as a creditor nation – in 1940 under 4 per cent. of its foreign investments were at short term and income from these investments exceeded payments to foreigners by $330 million. Foreign dollar assets, on the other hand, were largely of the emergency reserve type, over 40 per cent. being at short term, earning on an average of all investments only 2.0 per cent. against 4.7 per cent. earned by U. S. investments abroad.

In September 1939 the attitude of the United States was still determined by the Johnson Act of 1934, which prohibited the granting of credit by U. S. citizens to any country that had defaulted on its obligations to the United States, and by an amendment made to the Neutrality Act of 1937, which replaced the embargo on the export of arms by the "cash and carry" clauses. In practice, under these laws the United States would supply war materials to the British and French Empires in so far as they could pay for them in cash, on strictly business terms, and could ship the goods themselves. On these conditions British and French armament orders were placed, and, after the French armistice in June 1940, the British took over many of the French commitments.

Before the outbreak of war in 1939 the United Kingdom had a total holding of international resources of about £5,000 million*: foreign long-term security investments outside the United States were estimated at some £3,900 million, of which about £2,250 million was in the British Empire, £1,000 million in Latin America, £300 million in the Far East and £250 million in Europe. In addition, and of most importance as regards purchases made in the United States, was the holding of some £1,100 million, say nearly $4,500 million, in gold and dollar assets.

Some details regarding this gold and dollar holding and its utilisation up to the end of August 1941 are given in the table on the next page.

"Cash and carry" took a heavy toll of the British reserves, and by the end of 1940 the dollar position was acute. Looking back in November 1941 the British Prime Minister said, "this time last year we did not know where to turn for a dollar ... the end of our financial resources was in sight, nay, had actually been reached".

* This £5,000 million, it may be noted, is almost exactly equivalent to the U. S. holding of nearly $20,000 million at the end of 1939, given in the table on the previous page: the U. S. holding is, however, net, while the British had certain counter-liabilities such as the overseas and foreign holdings of sterling balances. Later figures in this paragraph, giving British investments abroad, are taken from the data presented by the U. S. Secretary of the Treasury during hearings of the Lend-Lease Bill, based on studies made mostly by British economists before the war.

British Gold and Dollar Resources.

In millions of dollars	Immediately liquid		Other		Total
	gold	dollar balances	market securities	business investments	
Total holding 31st August 1939	2,038	595	950	900	4,483
Less amounts unavailable (1)	51	305	92	290	738
Available for spending 31st August 1939. .	1,987	290	858	610	3,745
Actually spent up to 31st December 1940 .	1,746	236	334	—	2,316
Available for spending 1st January 1941 . .	241	54	524	610	1,429
Realised	141	—	244	115	500
Pledged with R. F. C. (2)	—	—	205	495	700
Total realised and pledged to 31st August 1941	141	—	449	610	1,200
Available for spending (3) 1st September 1941	100	54	75	—	229

(1) Some of these amounts were only later shown to be unavailable. Of the gold holding, it was stated at the end of 1940 that $30 million was scattered in different parts of the world and $21 million was held against outstanding forward exchange contracts. Private dollar balances, shown at $305 million, were considered to be at the minimum level necessary for the transaction of current business. Of the market securities, $62 million were not readily marketable and over $30 million consisted of some 1,100 marketable stocks in small holdings which could not immediately be mobilised. The estimate of business (or "direct") investments given as "not in excess of $900 million" at the outbreak of war was later shown to include $290 million held in the United States in the names of British beneficiaries, in trusts which, under U.S. law, might be unavailable to the British Government, at least for the time being. The value of business investments in liquidation, especially if forced, may be lower than the book value and, in at least one notable instance, was indeed shown to be so.

(2) Including securities held for pledging: $200 million of the business investments were pledged only as to earnings.

(3) i.e. available from the original reserves. In addition, $325 million of the R. F. C. credit had not been utilised so that the total available dollar resources amounted to £554 million. The entire credit of $425 million appears to have been drawn by the end of March 1942, when the official public debt statement gave the figure of £109.6 million as the total of external borrowing during the war.

From the outbreak of war to the end of 1940 nearly $1,400 million had been paid to the United States on British Government orders; $660 million deliveries had been made and the remainder represented advance payments and capital assistance to U. S. suppliers. But this was not all. A further deficit of more than $900 million on current dollar receipts and outgoings had to be covered, so that over $2,300 million of Britain's pre-war gold and dollar reserves had been used up.* As this sum exceeded the total immediately liquid, three mobilisations of British-held dollar market securities were made in 1940 (in February, April and December) and the proceeds utilised to replenish the liquid reserves.

At the beginning of 1941 drastic measures were called for: less than $300 million was immediately available in gold and dollars, while further British Government orders for nearly $1,400 million had already been placed. Another mobilisation of dollar market securities was made in January 1941, and negotiations went forward for the realisation of business investments: two of the largest, estimated on a book-value basis to be worth $115 million, produced

* Current dollar receipts of the sterling area for the sixteen months to the end of 1940 were $1,810 million (of which over half was from dishoarded and currently-mined gold). Payments amounted in all to $4,126 million: in addition to British Government orders of $1,380 million, $2,021 million was paid to the United States, $225 million to Canada and $500 million in gold and dollars to other countries. $200 million of the payments to the United States was on account of current U. S. export credits to the United Kingdom, outstanding at the outbreak of war, which had to be repaid under the "cash and carry" clauses.

only $80 million for the British Treasury. Further, nearly $50 million of British investments in plants of American suppliers who had received capital assistance from the British Government were acquired by the U. S. Defense Plant Corporation. But the proceeds from all these measures were insufficient to cover the volume of orders already placed and were of little importance compared with the potential manufacture of armaments in the United States.

A fundamental change in the situation took place with the passage of the Lend-Lease Act on 11th March 1941, which not only gave immediate relief to the British reserves as regards new orders placed but removed financial inhibitions that had hitherto restricted the volume of orders. The Act provided for the furnishing of war materials, food and other supplies to nations "whose defence the President deems vital to the defence of the United States". Payment was deferred and might eventually take a form "in kind or property or any other direct or indirect benefit which the President deems satisfactory". The extent of the aid contemplated was indicated by the appropriations under the Act, $7,000 million(1) in March and $5,985 million in October 1941, raised by later appropriations to a total, for all countries concerned, of $48,000 million in May 1942.

But orders placed prior to the Act had to be paid for, as well as other U. S. exports not coming under the lend-lease procedure. A fifth mobilisation of marketable dollar securities was made in April 1941. In July the Reconstruction Finance Corporation granted a credit directly to the British Government — $425 million at 3 per cent. for 15 years. This credit was secured by practically the whole of the remaining dollar investments, amounting to $500 million: $205 million marketable, $115 million non-marketable and $180 million investments in U. S. insurance companies; in addition, the income on $200 million British insurance company stocks was pledged to cover the service of the loan. In August 1941 a further batch of U. S. securities was vested in the British Treasury and used as the collateral for the R. F. C. loan.

The previous table shows that, in the eight months to the end of August 1941, $500 million of securities had been liquidated(2); in addition, $100 million had been utilised from the R. F. C. credit, making a total of $600 million. At the end of August only $229 million was left from the original gold and dollar resources (a small amount of marketable securities remained, but the whole of the direct investments had been realised or pledged). To these reserves must be added the further commitment of the R. F. C. at $325 million, making a total of $554 million available dollar resources.

To illustrate the changes produced by the lend-lease procedure, the table on the next page has been prepared.

In the thirty-three months of war to the end of May 1942 British orders in the United States under "cash and carry" terms amounted to slightly less than $3,300 million (an average of nearly $100 million a month); in the fifteen months

(1) Including up to $1,300 million for transfers of armaments in stock or procured from earlier appropriations.
(2) There was a loss of $35 million, compared with book value, on the realisation of direct investments, but $46 million was received from the U. S. Defense Plant Corporation.

of lend-lease to May 1942, expenditure amounted to $4,500 million (an average of $300 million a month). The United States thus again became an important exporter of capital — "the special type of capital transfer resulting from lend-lease operations", as it is called by the U. S. Department of Commerce in its recent publication on the Balance of Payments. A new agreement signed on 23rd February 1942 between the United States and the United Kingdom provided for transfers of lend-lease in both directions and stipulated that, in the final determination of the benefits to be provided in return for aid furnished, the terms and conditions "shall be such as not to burden commerce between the two countries". On the same day the President of the United States signed a bill removing the restrictions imposed by the Neutrality Act upon financial transactions between the United States, the United Kingdom and other co-belligerents.

"Cash and carry" and "lend-lease" expenditures.

Number of months	Expenditures over periods ended	British Government "cash and carry" expenditure in the United States (1)	Lend-lease expenditure (2)	Drain on British gold and dollar reserves (3)
		Totals, in millions of dollars		
16	1940 December.	1,380	—	2,316
2	1941 February .	227	—	150
6	August . .	680	487	450
6	1942 February .	500	2,083	150
3	May. . . .	166	1,925	—
		Monthly averages, in millions of dollars		
16	1940 December.	86	—	145
2	1941 February .	113	—	75
6	August . .	113	81	75
6	1942 February .	83	347	25
3	May. . . .	55	641	—

(1) Based on official statistics given in the Federal Reserve Bulletins for February and December 1941. Expenditure on account of British Government orders was $1,380 million from 1st September 1939 to 31st December 1940 (sixteen months). Of $1,393 million orders outstanding on 1st January 1941, $907 million were paid for during the period up to 31st August 1941 (eight months, split into two parts in the table to correspond with lend-lease periods) and a further $457 million orders had been placed; estimated payments were $500 million from 1st September to 28th February 1942 (six months), while the $443 million remaining on 1st March 1942 may have been spread over eight months.

(2) Based on lend-lease actual expenditure as given in the quarterly reports of the President of the United States.

(3) Based on official statistics as under (1) above. The reduction in gold and dollar reserves was $2,316 million in the first sixteen months and about $600 million in the next eight months ($500 million of reserves had been liquidated and $100 million drawn on the R. F. C. credit). It was estimated that a reduction of $150 million would occur in the six months to the end of February 1942, while the balance then remaining would be covered by the surplus of current dollar receipts over the following eight months. The estimate for the last period was made before the Japanese invasion of Malaya and may be subject to some revision on that account. "Current dollar receipts" may involve some drawing on sterling-area capital resources, e. g., the receipt of gold from South Africa in repayment of South African Government securities for £30 million in the autumn of 1941.

Before the coming into force of lend-lease procedure with the United States, relief to the drain on British gold reserves had been given by Canada's renunciation of payment in gold. The financial arrangements of the United Kingdom with Canada (which is outside the sterling area) may be divided into three phases.

In the first phase, which lasted for sixteen months up to the end of December 1940, Can. $250 million of the deficit of Can. $610 million was paid in gold, an amount approximately equivalent to the cost of materials Canada had to buy in the United States to carry out British Government contracts without drawing on Canadian gold and dollar resources (estimated at

Sterling area deficit on account with Canada[1].

In millions of Canadian dollars	Period covered in months	Covered by				Total deficit	Average monthly rate of deficit
		Gold shipments	Repayment of Canadian debt [2]	Interest-free loan from Canada	Gift from Canada		
1st Sept. 1939–31st Dec. 1940	16	250	360	—	—	610	38
1st Jan. 1941–31st March 1942	15	—	480	700	80	1,260	84
1st April 1942–31st May 1942	2	—	—	—	220	220	110
Total of the three periods	33	250	840	700	300	2,090	63

(1) The figures for the first period are those given in official U. S. sources, converted into Canadian dollars. For the second period the difference has been taken between these data and those published officially in Canada for the first 31 months, in connection with the United Kingdom Financing Act 1942. The amount of the Canadian contribution in the third period is given in the British Government's regular revenue returns; the sterling amount has been converted into Canadian dollars.

(2) The Can. $360 million for the first period also covers some accumulation of Canadian sterling balances, the exact amount of which has not been published. For the second period these balances were used to repay Canadian sterling debt: thus the total of Can. $840 million for the two periods together applies exclusively to repayment of debt (mostly Canadian Government sterling securities but including also some private Canadian debts in the U. K.).

U. S. $1,570 million at the outbreak of the war*): the balance of Can. $360 million was covered by the repatriation of Canadian debts in sterling and the accumulation of sterling balances.

In the second phase, when the current deficit of the sterling area to Canada was running at more than double the former rate, no more gold was shipped, the whole deficit being covered by repatriation of Canadian sterling debt and the accumulation by Canada of sterling balances. This procedure was facilitated by an agreement made in April 1941 between Canada (which does not avail itself of lend-lease terms) and the United States, whereby Canada's purchases of component parts in the United States, for use in carrying out British contracts in Canada, would be supplied under the Lend-Lease Act on United Kingdom account.

By the end of the second period, Can. $840 million of Canadian sterling debt had been repatriated or repaid since September 1939 and Can. $700 million of the accumulated sterling holdings of Can. $780 million had been converted into an interest-free loan to the British Government (the terms to be settled after the war); it was also decided to make a gift of Can. $1,000 million to the British Government, and the remaining Can. $80 million of sterling balances on 31st March 1942 was booked to this account.

In the third and present phase, which is very similar in its effect to the lend-lease procedure, the whole of the current deficit is covered by the free delivery of armaments, raw materials and foodstuffs. In the two months up to the end of May 1942, British Government statistics show the receipt in this way of goods valued at £49.4 million.

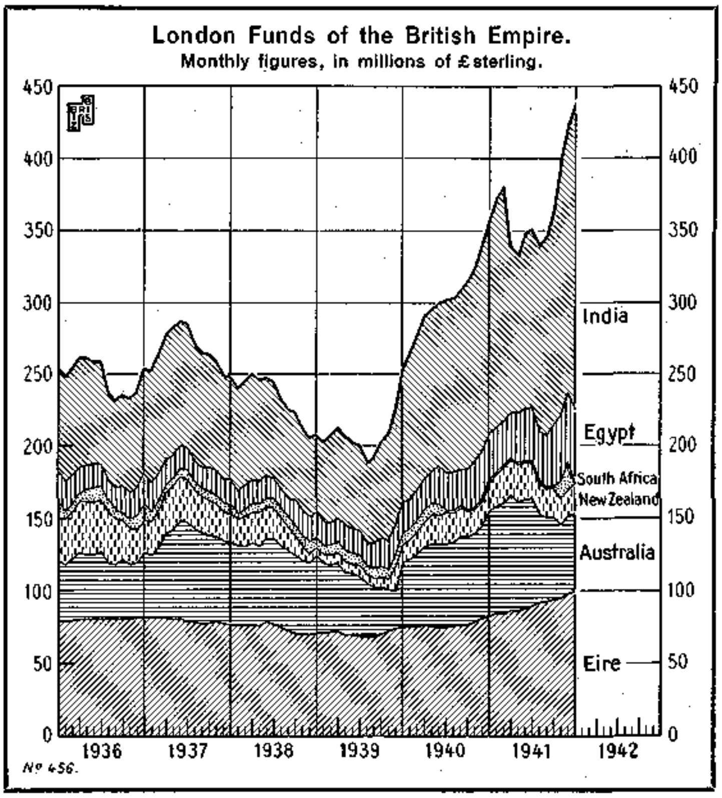
In the thirty-three months of war up to the end of May 1942, the deficit of the sterling area to Canada amounted to somewhat over Can. $2,000 million

* This estimate includes securities and other U. S. dollar holdings in private hands. The total for all Empire countries, including Canada, was estimated at U. S. $2,255 million at the outbreak of war.

(an average of Can. $63 million a month), of which 40 per cent. was used to repatriate earlier Canadian debts to the United Kingdom. To facilitate these repatriations, several acquisition orders were made by the British Government, whereby Canadian securities previously in private hands were mobilised, as was the case for U. S. securities also.

Inside the sterling area, the resources of the United Kingdom do not run the danger of being exhausted (so long as sterling-area countries have debts to repay in sterling or accumulate sterling assets), and special arrangements as regards payments, as with the United States and Canada, have not been made. The graph on this page, which covers the bulk of the liquid sterling resources of the principal Empire countries, apart from Canada, shows that these resources have increased from under £200 million at the outbreak of war to nearly £450 million at the end of 1941: a large proportion of this sum is held as balances or in Treasury bills; and in 1941 both Treasury deposit receipts and "tap" Treasury bills were made available as investments for Empire central banks. Of the increase of £250 million in sterling resources, over £150 million was on account of India and less than £100 million for the other five countries taken together. But these figures do not take account of repatriations and repayments of debts in sterling.

The decline of the Reserve Bank of India's sterling holding in the early months of 1941 was the result of the payment of £65 million to United Kingdom residents on account of mobilised Indian Government sterling loans; in March 1942 another temporary decline in the Reserve Bank's sterling holding by some £60 million reflected a further repayment of mobilised Indian Government sterling securities. The last remaining Indian Government sterling security, amounting to £77 million, was notified for redemption on the due date in January 1943. The Indian accumulation of sterling (including repayment and redemption of securities) from the beginning of the



war up to the end of 1941 amounted to about £230 million (equal to some three-quarters of Canada's accumulation, which may be put at about £300 million for the same period); £135 million of India's accumulation was made in 1941.

The London funds of Australia and New Zealand together rose from some £40 million at the outbreak of war to slightly over £100 million in the first half of 1941, but fell in the second half of the year to £75 million in December, considerably more than the usual seasonal reaction. British Government purchases of Australian goods continue, wool sales, for example, amounting to some £125 million in the two seasons since the war; cash payments are made even if, through shipping difficulties, the goods remain in storage in Australia. Several repayments of overseas debt were made in 1941, totalling about £15 million (including a small amount in U. S. dollars); while, in the year to June 1941, £12 million was advanced by the British Treasury to cover Australian war expenditure abroad, this assistance may be dispensed with in the current year. The London funds of New Zealand fell in the second half of 1941 to the same level as a year previously, partly as a result of the repayment to the British Treasury of the full amount of advances made for war expenditure abroad up to March 1941.

South Africa holds very little in the way of short-term sterling assets, there being, indeed, a net reduction from £7 million at the outbreak of war to under £1 million at the end of 1941, with an interruption in October and November 1941, when amounts as high as £20 million were held temporarily by the Reserve Bank in connection with the redemption of sterling debt. In July 1940 a maturing Government loan for nearly £8 million was redeemed; in October 1941 an acquisition order was made covering about £30 million of South African bonds held in London and these securities were repaid by the end of the year.

The sterling reserves of the National Bank of Egypt rose from £20 million at the outbreak of war to £50 million at the end of 1941, one-half of the increase of £30 million taking place in the last six months. The strengthening of the reserve position is the result of British Government purchases of cotton during the past two seasons and the expenditure of British and Imperial forces (which at the end of 1941 exceeded the value of the country's exports). The net sterling assets of the banks in Eire plus those of the Currency Commission have grown from £70 million at the beginning of the war to £100 million at the end of 1941, over one-half of the increase taking place in the past year; the rise in sterling reserves is due to the difficulties of import and the surplus on invisible account (which includes some £13 million income from investments abroad).

Several countries which are not included in the graph, as regular monthly statistics are not received, have also had appreciable increases in their holdings since the war, particularly in 1941. Among these are the Crown Colonies and other territories with currency boards which, before the war, had reserves in sterling totalling some £50 million. Most important was the Straits Settlements with £17 million at the end of 1939; this colony was selling U.S. dollars (on account of exports of tin and rubber) at a net annual rate equivalent to at least £40 million until December 1941, the proceeds going to increase the colony's sterling reserves, which are estimated to have reached some £100 million before the occupation of the country by the Japanese. The other Malay States also increased their sterling reserves and, in October 1941, made an interest-free loan of £2 million to the British Government for the duration of the war. Other currency boards which have increased their sterling holding since the war are those of East Africa, West Africa, Irak and Palestine (an adverse trade balance, in the latter case, being offset largely by British Government grants and the expenditure of Imperial troops).

Relations with Dutch possessions were regulated by the monetary agreement of 14th July 1940 between the British and Dutch Governments, whereby balances should accumulate in sterling to be repaid ultimately at a fixed exchange rate. With regard to the Dutch East Indies (particularly Java), this arrangement worked until the invasion by the Japanese at the end of February 1942. But the Dutch West Indies (particularly Curaçao), which had a high proportion of dollar imports and were accumulating sterling at the rate of over £1 million a year, made a request towards the end of 1941 for some repayment of the sterling balance in dollars. Thailand was also a member of the sterling area until its occupation by Japan, when some £17 million of sterling assets, mostly the property of the note-issuing authorities, were blocked. Of considerable importance has been the surplus of British imports from the Belgian Congo, amounting to about £10 million in 1941, payment for which has been allowed to accumulate as sterling balances.

Of the South American countries, by far the largest accumulation of sterling was made by the Argentine (which also took over sterling assets from Paraguay and Bolivia in settlement of claims on those countries). The amount accumulated on the sterling special account has not been published but early in March 1942 the Finance Minister revealed that, since November 1941, £4.1 million Argentine bonds had been repatriated from Great Britain. Of the £30 million odd Argentine Government debt outstanding in London, almost two-thirds is subject to redemption on short notice at the option of the Argentine Government, so that a further outlet for accumulated sterling balances remains.

In Europe the holding of sterling as a currency reserve is practically confined to Portugal and Iceland. The "other" foreign exchange of the Bank of Portugal, not entirely in sterling, rose from the equivalent of £7 million in December 1940 to £29 million in December 1941. The "foreign correspondents" of the National Bank of Iceland rose from the equivalent of under £0.05 million at the end of 1939 to £2.3 million in December 1940 and £5.1 million in December 1941, in addition to military expenditure, largely the result of increased fish exports to England.

Excluding lend-lease, the contribution to British war finances made by the utilisation of external reserves or the accumulation of foreign debt, as sterling balances or in other ways, is described in the British White Paper as "overseas disinvestment" and was given as approximately £760 million in 1940 and £800 million in 1941. These global figures hide, however, an important shift in direction: in 1940 net expenditure in gold and U. S. dollars accounted for over 60 per cent. of the total overseas disinvestment while the sterling area contributed under 40 per cent.; in 1941, as lend-lease operations got under way and Canadian balances were built up in London, net expenditure in gold and U. S. dollars fell to little over 20 per cent. of the total overseas disinvestment, while the sterling area contributed nearly 80 per cent. Part of this disinvestment has taken the form of realising foreign assets and part the accumulation of debts to be settled after the war.

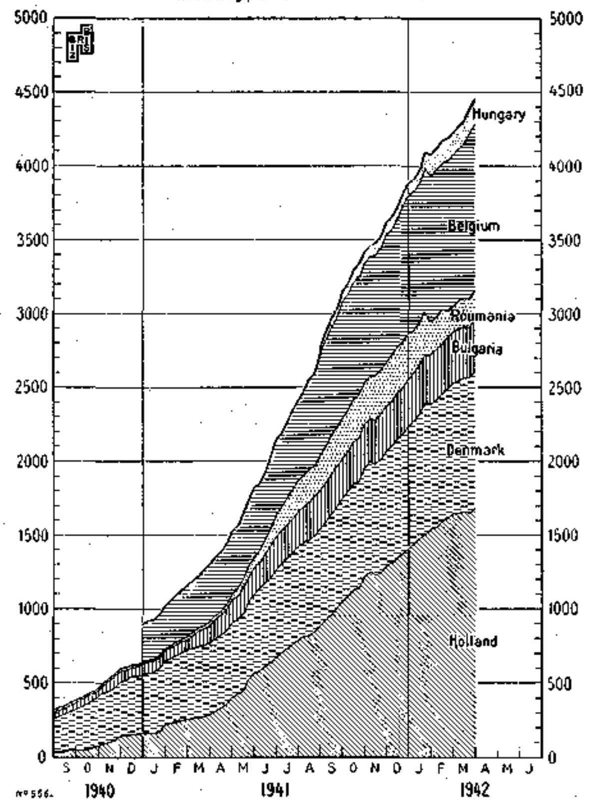
Germany also, especially since the middle of 1940, has been in a position to obtain a considerable volume of additional supplies from other countries, not least through the working of the European clearing system. The outbreak of war cut off the 40 per cent. of German exports previously directed towards the markets of belligerent and overseas countries and, in the first months of hostilities, these export goods tended to find an outlet in Continental Europe. Germany thus obtained an active trade balance, reducing or wiping out previous clearing debts and, in the first half of 1940, acquired small credit balances against countries which previously had been Germany's principal creditors in the clearings, e. g. Holland, Italy and Switzerland.

During 1940 there was a change in Germany's export policy and a number of new clearing agreements were signed, generally removing financial obstacles to the freedom of export from continental countries to Germany. From the middle of 1940 there was a reaccumulation of German clearing debts, which was accelerated in 1941, to aggregate figures some ten times the previous peak of RM 567 million in March 1935.

Statistics regarding the clearings are not published in Germany, but a number of European countries make figures available, with varying degrees of completeness and regularity, showing their position on some of the clearing accounts with other countries (including Germany). Where central banks regularly make advances to exporters and other domestic creditors in the clearing (now a general feature in these agreements), weekly information is often available from the bank returns; and on the basis of this material the following graph has been constructed, amounts in local currencies being converted into Reichsmarks for purposes of comparison.

These curves represent generally the total advances made directly by central banks against outstanding claims on clearing and similar accounts with all other countries, including Germany (which is, in fact, the dominating influence in all cases). At the end of 1941 the curves shown in the graph had risen to the equivalent of the following approximate figures:

Clearing Claims
(and assimilated accounts).
the equivalent in Reichsmarks (at clearing rates) of advances made in domestic currencies to home exporters and other clearing creditors by certain European central banks (including some other items of a similar nature).
Monthly, in millions of RM.



Holland, RM 1,400 million*; Denmark, RM 820 million; Bulgaria, RM 320 million; Roumania, RM 310 million; Belgium, RM 940 million and Hungary, RM 85 million; the total being nearly RM 3,900 million, of which RM 3,000 million was accumulated during 1941. As these figures cover only the clearing items appearing in central-bank weekly returns, they do not give a complete picture; Reichsmark assets such as those arising from the financing of clearing claims by commercial banks (e.g. in Hungary) or the purchase of Reich Treasury certificates by commercial banks (e.g. in the Protectorate) fall naturally outside the clearing statistics.

Other countries (for which regular figures are not available) also had clearing claims against Germany: in France the government advanced Fr.fcs 12 milliard (RM 600 million) against assets in the clearing with Germany during 1941 while, in the first half of 1942, the German debt appears to have increased at the average rate of RM 120 million a month, which would carry the total debt up to about RM 1,500 million in June 1942; to Slovakia the German clearing debt, including the Protectorate, increased from Ks 1,000 to 2,000 million (from RM 85 to 170 million); the German debt to Greece, which was under RM ½ million in September 1940, had risen to RM 39 million in September 1941 and to RM 78 million in May 1942. In addition, credits in the clearing were granted to Germany for 1941 by Switzerland (not to exceed Sw.fcs 400 million or RM 230 million) and by Sweden (S.Kr. 100 million or RM 60 million): actually the German clearing claim of S.Kr. 100 million against Sweden at the end of 1940 was turned into a debt of S.Kr. 72 million at the end of 1941 (a total change-over slightly exceeding RM 100 million). Further, the item in the balance sheet of the National Bank of Bohemia and Moravia under which Reichsmark assets are booked

* The annual report of the Nederlandsche Bank for 1941–42 states that during the year to 31st March 1942 the bank purchased Reichsmarks to the value of RM 2,183.1 million and sold RM 691.6 million, so that the Reichsmark holding increased in the twelve months by RM 1,491.5 million.

rose during 1941 by the equivalent of RM 500 million; and German clearing debts of an unknown amount were incurred towards Italy.

On the other hand, Germany had credit balances against a few countries: Finland's clearing debts to all countries had increased to the equivalent of RM 75 million at the end of 1941 and Croatia owed to Germany about Kunas 1,000 million (RM 50 million), of which only one-third arose from commercial exchanges.* Germany had some RM 35 million frozen in Turkey in the autumn of 1940, but Turkish deliveries led to a rapid reduction of the total, and a new agreement, designed to obviate the accumulation of Spitzen, was signed in October 1941. By and large, it may be taken as an indication of the order of magnitude, that German debts on clearing and similar accounts increased during the year 1941 by over RM 5,000 million.

Foreign trade statistics are not available in sufficient completeness to show how far the accumulation of clearing balances was due to the movement of goods, but countries like Denmark and Bulgaria, which had a passive balance of trade during the year, nevertheless added considerably to their clearing claims. This is partly due to differences in the terms of payment. The annual report of Danmarks Nationalbank for 1940 refers to the "modification made to the financing of foreign trade, the payment in cash, or in advance, of goods imported having become the most usual form of payment, whereas previously imports enjoyed, in general, credit terms of several months". But German imports of food from agricultural and other countries are generally paid for in cash into the clearing, while its exports of heavy industrial goods are often made on credit for months or even years. Both Roumania and Bulgaria, for example, have issued government, or government-guaranteed, securities in Reichsmarks to cover orders placed in Germany. Bulgaria, however, has utilised a part of its Reichsmark (non-interest-bearing) clearing balances to repurchase from the German heavy industry Bulgarian Government seven-year Treasury bills (bearing interest at 5 per cent.) previously given in payment of orders: in this way the central bank and not the foreign exporter has become the creditor of the Bulgarian Government. On the other hand, Germany has recently granted new credits e. g. to Roumania, to facilitate the placing of orders.

In addition, capital movements and other "invisible" items of various kinds have been very important. German capital moved towards the bourses in certain neighbouring countries, particularly Holland, and was invested on a considerable scale in industrial and other undertakings, increasing, in some of these cases, the Reichsmark holdings of the countries concerned.

In this connection the development of German banking relations in European countries should be mentioned. Whereas, after the summer campaign of 1940, there was an extension of German commercial banking (principally

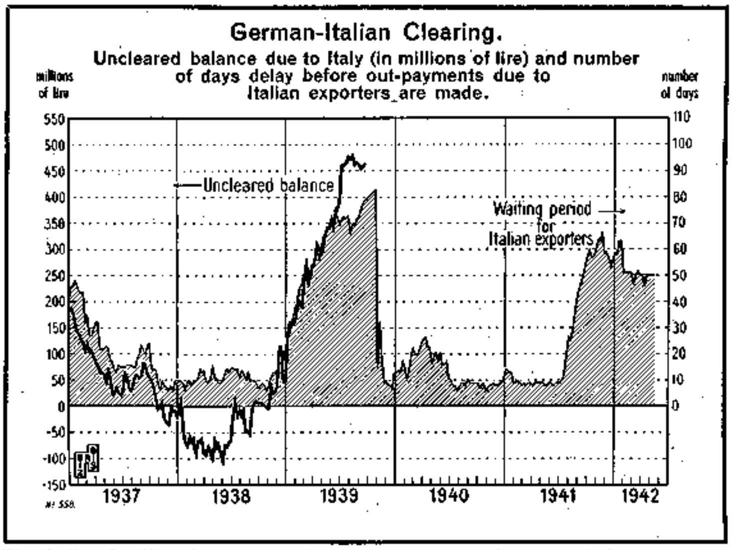
* Serbia, on the other hand, was reported to have made considerable exports and to have accumulated a claim on Germany of about RM 70 million at the end of May 1942, although, on separate account, it was debited with 29 per cent. of the former Yugoslav commercial debt of RM 77 million.

by the big Berlin banks) in western European countries, in 1941 German banks acquired new interests, particularly in the Balkans (facilitated by existing interests in the Ostmark and Protectorate) and in the occupied Baltic and eastern territories. The expansion generally took one of three forms: the opening of branches or agencies of the German bank, the acquisition of majority share-holdings in local banks, or the establishment of new institutions by German banks in collaboration with local banks; in Greece, however, where Italian banking interests are also prominent, German banks work in close agreement with existing local banks. The banking network thus built up has assumed considerable importance in connection with the financial relationships of these countries to Germany.

Further, German "service" items were as a rule passive; for Denmark the earnings of shipping under German control constituted a large item in the balance of payments; the savings remitted home by foreign workers in Germany were a considerable and growing factor for many countries; for, e. g., Roumania and Bulgaria, the expenses of German troops, stationed in, or supplied from, their territories, were very important. The treatment of Reichskreditkassenscheine exchanged or withdrawn has not been uniform in the various countries where they were issued: in some cases they have been debited to clearing account; in Belgium the Bank of Issue shows them as a separate claim against Germany in its return (included as one of the assimilated accounts in the statistics on which the graph is based and accounting for nearly one-third of the Belgian claim at the end of 1941); Reichskreditkassenscheine withdrawn in France, however, have been paid out of the costs of occupation and thus cease to be a German liability. The advances made by Danmarks Nationalbank to the occupying authorities are booked as a German debt in Reichsmarks in the bank's accounts and about one-half of the RM 800 million claim shown in the graph is due to this factor, the other half being the clearing proper. But sums paid on account of occupation costs in France and Belgium do not appear in the clearing accounts: for purposes of comparison it may be mentioned that occupation costs equivalent to RM 6,500 million were paid by France in 1941, of which RM 5,340 million were actually utilised, while occupation costs were included in the Belgian budget for 1941 at the equivalent of RM 1,300 million.

The German clearing with Italy is of particular interest as being the focal point of the clearing system in Europe. No figures regarding the operations of the accounts are published from the German side but regular weekly statements are made in Italy of the dates of the last out-payments to Italian exporters (thus showing the number of days which Italian exporters have to wait for payment, owing to administrative procedure and the lack of available lire from the in-payments of Italian importers); further, the amounts outstanding in lire were published weekly until September 1939. These data have been assembled in the following graph.

A net balance due to Italy was repaid during 1937 and an Italian debt running up to Lit. 100 million (say, RM 13 million) was incurred during the first



German-Italian Clearing.
Uncleared balance due to Italy (in millions of lire) and number of days delay before out-payments due to Italian exporters are made.

The Italian Institute for Foreign Exchange issues certificates to Italian exporters to cover the waiting time until their claims are met from lire in-payments by Italian importers. These certificates are accepted by Italian banks up to 75 per cent. of their face value for advances, while exporters may also obtain guarantees to cover the exchange risk.

half of 1938: between the autumn of 1938 and September 1939, Italian credits against Germany rose sharply to above Lit. 450 million (RM 60 million). From that date no amounts were published, but the number of waiting days for Italian exporters fell rapidly to under ten at the end of 1939. A period of about 8–10 days must be reckoned the minimum waiting period, due to administrative procedure, even when Italy had a net debt on the clearing account.

An important influence on the clearing in 1940 was the capital transfer by Italy of amounts due as compensation for property left behind by Germans repatriated from the South Tyrol. In 1941 (and also in 1942) a not inconsiderable factor in the opposite direction was the transfer of savings made by the 300,000 Italian workers in Germany to their home country. It is known from German sources that early in 1941 Italy had a debt in the clearing. But from June 1941 the situation changed and there was a rapid lengthening in the waiting period for Italian exporters, which reached about two months at the beginning of October, falling early in 1942 to fifty days and becoming stabilised around that figure (see below).

The German-Italian clearing has thus shown, over the years, a tendency to equilibrium, a debt on one side of the account swinging over in course of time to a debt on the other side. In February 1941 it was agreed between Germany and Italy that the export from one country to the other of goods important for the war effort should not be delayed on account of the technical state of the clearing accounts, i. e. a temporary deficit arising on one side or the other. This principle of the German-Italian agreement was confirmed in March 1942. Further, it was agreed that Italian recipients of payments from Germany in respect of wages, pensions, representations, etc. should in future not have to reckon with delay and that suitable measures for the provision of credit would be taken with regard to other payment exchanges, so that waiting periods should henceforth not amount to more than fifty days. In a semi-official commentary on the agreement it was stated, inter alia, that an uncleared balance stood to the credit of Italy.

The monetary importance of clearing claims may be illustrated by the following comparisons made on the basis of figures at the end of 1941 in countries where the Reichsmark claims are financed by the central bank. In Denmark, claims against Germany amounted to double the note issue; in the Protectorate, the item comprising Reichsmark assets was one-third higher than the note issue: in other countries the clearing claims were less than the note circulation but in some cases constituted a high percentage; in Bulgaria, 80 per cent., Holland, 50 per cent., Belgium, 25 per cent., Roumania, nearly 20 per cent., and Hungary, 7 per cent. In most of these cases immediate advances, for the whole of his claim, are made directly to the exporter by the central bank (with a government guarantee to the central bank for the exchange risk).

Before official credits of this nature were granted against uncleared balances, exporters had to bear an exchange risk and await their turn for payment in chronological order. If one country's exports to another greatly exceeded its imports, the resulting growth of clearing claims caused a delay in payments to its exporters (whose working capital was in this way tied up) and thus acted as a brake upon further exports until the position was righted. This system is still in force to some extent in a few European countries. The full counterpart in the local currency of debts run up in the clearing by Germany to Italy, Sweden and Switzerland is not paid out immediately the exporter acquires his claim, so that the exporter himself may have to bear at least part of the credit or exchange risk for a certain waiting period (limited to 90 days in Switzerland and 50 days in Italy); while in Slovakia the central bank had advanced only Ks. 845 million at the end of 1941 on a total clearing claim of Ks. 2,000 million.

But in most other European countries, by advancing payment to domestic exporters immediately the foreign counterpart is received, the government or central bank has taken the burden of export financing upon its own shoulders, and the automatic check on the growth of clearing claims has thus been removed. The consequence has been a more or less considerable expansion of central-bank credit with no counterpart in increased supplies of goods on the home market. The President of the National Bank of Hungary in his report on the year 1941 explained how "the discrepancy between incomes and available consumption goods was .... accentuated by the credits granted to foreign countries for the financing of the growing exports; the utilisation of these credits raised the purchasing power at home without the volume of goods available being increased by corresponding imports".

Measures to counteract the undesirable effects of the resulting maladjustments have taken two principal *lines*: attempts to reduce the clearing claims (and thus the outstanding advances against them) and attempts to offset or sterilise the effects of the advances given.

Examples of efforts to reduce clearing claims or to prevent their further growth may be cited: the Nederlandsche Bank has offered facilities to encourage the investment of Dutch capital in Germany*; the Slovak National Bank

* A further step was taken in the spring of 1942 with the creation of the Nederlandsche Oost Compagnie, with the President of the Nederlandsche Bank at its head. The new company was founded to encourage and facilitate, by the granting of appropriate credits, a movement of Dutch population to the eastern territories occupied by Germany.

has placed specially cheap credits at the disposal of importers; in Bulgaria an agreement was reached in January 1942 limiting the exchange of the local currency against Reichsmarks for the use of German troops and labour corps to RM 100,000 a week; and a series of movements occurred in the return of the National Bank of Roumania in January–February 1942, the net result of which was a reduction of the clearing claims by Lei 6½ milliard (to Lei 10½ milliard), while the gold holding jumped by Lei 3 milliard and the advances to the government rose also by over Lei 3 milliard (as Reichsmark claims were transferred to the government for the repayment of debts or for other purposes). A further method employed has been the revalorisation of German claims on the countries concerned. Thus agreements were made with Hungary, Roumania and Yugoslavia for the repayment in cash of German holdings of pre-war (1914–18) loans issued by these countries; no information as to the amounts involved has been published. In a somewhat similar way Slovakia has repaid Ks. 300 million of the old Czecho-Slovakian debt through the clearing to the Protectorate.

Attempts to neutralise or minimise untoward monetary effects also take the form of credit measures: the National Bank of Bohemia and Moravia has for a long time issued Kassenscheine to mop up surplus funds on the market; the National Bank of Belgium has recently decided to pay clearing creditors, for claims above a certain amount, only in blocked Treasury bills; and the Slovak National Bank pays exporters but blocks the transfer of financial claims.

The first world war turned the United States from a debtor to a creditor country and impaired the international position of the European belligerents. The second world war is turning Canada and India and perhaps other overseas countries into creditors on international account, while in 1941 Germany accumulated debts on clearing account of over RM 5,000 million and England's foreign disinvestment was as high as £800 million*. Although these sums provide sustenance to the belligerents in their war efforts, the magnitude of the figures gives some measure of the changes which have occurred in the international capital structure.

What the exact situation will be when the war is over it is, of course, impossible to say at the present time, but it is evident that such fundamental shifts in debtor-creditor relationships must give rise to important changes in the currents of trade. Immediately after the war, the first needs of European and other countries will be for the reconstitution of stocks and replacement of plant and for the repair and reconstruction of damage due to the war. In order to provide for these needs and at the same time for the changes on capital account, some countries will, no doubt, find it imperative to increase their exports. Whether or not they will succeed in doing so will depend partly on their own endeavours but partly also on the closely-connected trends of

* These figures relate only to the change in creditor-debtor relationships on international account and do not give the full measure of the contribution of foreign countries to the war effort of these two belligerents. In particular, they exclude the lend-lease aid to England and, for Germany, do not take full account of the payment of occupation costs by the occupied European territories and other foreign contributions which, added to the clearing debts, give a total estimated at RM 15–17 milliard in 1941 (see Introduction).

commercial policy and general business conditions. An export drive by the countries most in need has obviously more chance of success if the volume of international trade is expanding than if it is contracting. Much will depend upon the willingness of those countries to receive imports which have improved their position in the field of international debtor-creditor relationships, or which, by the nature of their production, are the principal suppliers of food-stuffs and raw materials. In their own interests, they have every reason to abstain from measures which unduly burden the international balances of payments.

For "principal suppliers" is a reciprocal term — it implies obligations as well as privileges, dependence as well as profits. The post-war welfare of the world demands that the large shifts in the international capital structure brought about by the war should be matched by broad adjustments of the future pattern of international trade in a way and to a degree which was not achieved in the interregnum between the two world wars of our time.

V. GOVERNMENT FINANCE, MONEY AND CAPITAL MARKETS AND THE STOCK EXCHANGES.

1. GOVERNMENT FINANCE, MONEY AND CAPITAL MARKETS.

Although receipts from taxation have generally risen in the past year, government borrowing continued to be the dominating factor in the money and capital markets of the world. The financing of actual war expenditure in the belligerent countries not only absorbed all the current savings but also led to some expansion in the volume of bank credit; in neutral countries defence expenditure took a lower proportion of the total budgetary outlay, but there also it constituted a heavy burden and accounted for the bulk of market borrowing; and, although military expenditure was practically eliminated from the budgets of the occupied countries in Europe, its place was taken by the considerable official financing for the payment of occupation costs and advances to domestic exporters and other creditors in the clearings with Germany.

Conditions on the money markets show some variations. In Germany and the United Kingdom, the markets remained very liquid; the same is true of certain European countries (notably Denmark, Sweden and Switzerland), where the public's demand for cash, as shown by the expansion in the note issue, has not been considerable. Before the United States entered the war, official measures of control tightened up the markets in New York; and more stringent conditions appeared in some European countries, where expansion of central-bank credit for official account was followed by a parallel increase in the note circulation (as was the case in Belgium and Holland). Most governments have shown themselves concerned to lengthen the maturities of their borrowing and to tie up savings rather than to borrow more cheaply; rates at long and at short term have thus generally ceased to fall and in several countries the policy of the authorities has avowedly been to stabilise them around existing levels. But on the stock exchanges of Continental Europe the rise in quotations has, in many cases, brought share yields down to abnormally low rates.

Although complete budget statistics are not published in Germany, figures of total borrowing and taxation are available and from these a broad picture of the situation may be obtained. The total income from these two sources, which was RM 40 milliard in the calendar year 1939, rose to RM 60 milliard in 1940 and RM 80 milliard in 1941.

Revenue from taxation increased from RM 27.2 milliard in the financial year 1940–41 to RM 32.3 milliard in 1941–42. In 1941 a 25 per cent. increase was made in the corporation tax, to produce some RM 1 milliard in a full year, and the war supplement to certain consumption taxes was also raised; on the other hand, various minor tax alleviations were granted. Income tax and the corporation tax (including the war supplements) plus the turnover

Reich Receipts from Taxation and Borrowing[1].

In millions of Reichsmarks	Taxation revenue	Internal debt increases or *decreases*									Total receipts from taxation and borrowing
		Short-term				Long and middle-term			Total borrowing		
		Reichsbank working credit	Treasury bills	"Sundry loans"	Tax certificates	Treasury certificates	Liquidity loans	Rentenbank loan	Gross	Net (less amortisations)	
1939 Aug.-Sept. .	4,430	*— 336*	2,392	—	1,750	—	278	400	4,484	4,467	8,897
Oct.-Dec. .	6,335	567	3,628	—	803	—	1,082	274	6,354	6,127	12,462
1940 Jan.-March	5,840	*— 470*	4,383	—	—	750	2,232	117	7,012	6,183	12,023
1940 April-June .	6,067	370	3,726	635	—	2,000	1,766	75	8,572	8,085	14,162
July-Sept. .	7,351	*— 59*	4,738	875	—	2,383	1,798	—	9,735	9,577	16,928
Oct.-Dec. .	6,987	*— 46*	4,509	—	—	2,717	2,597	60	9,837	9,772	16,759
1941 Jan.-March	6,816	*— 400*	5,421	411	—	3,787	1,373	—	10,592	10,155	16,971
1941 April-June .	7,176	719	5,420	664	—	3,479	1,333	65	11,680	11,503	18,679
July-Sept. .	8,606	*— 140*	6,700	1,168	—	3,000	2,825	—	13,553	13,293	21,899
Oct.-Dec. .	8,062	134	6,982	764	—	3,797	2,553	—	14,230	14,061	22,143
1942 Jan.-March	8,394	*— 445*	5,909	751	—	3,844	2,809	150	13,019	12,815(3)	21,209
Financial years											
1940-1941 . .	27,221	*— 135*	18,394	1,921	—	10,887	7,534	135	38,736	37,589	64,810
1941-1942 . .	32,258	268	25,011	3,347	—	14,120	9,520	215	52,482	51,672(3)	83,930
Calendar years											
1940	26,245	*— 205*	17,356	1,510	—	7,850	8,393	252	35,156	33,617	59,862
1941	30,680	313	24,523	3,007	—	14,063	8,084	65	50,055	49,012	79,691
August 1939-December 1941	67,689	339	47,899	4,517	2,553	21,913	17,837	991	96,049	93,223	160,912
Total debt outstanding at end of 1941 (2) . . .	.	895	55,214	4,520	3,541	32,865	23,151	991	.	128,506	.

(1) The statistics on taxation are those published officially, except for the two-months period August-September 1939, which is an estimate based on the official figure of RM 6,179 million for the July-September quarter. The figures on quarterly borrowing up to December 1941 are based on a table given in the weekly report of the Deutsches Institut für Wirtschaftsforschung for 31st March 1942.

(2) The grand total of RM 128,506 million includes, in addition to the amounts given separately in the table, the following principal items: the pre-April-1924 internal debt of RM 2,670 million, the pre-1931 foreign debt of RM 1,233 million and certain bonds issued in compensation (i. e. without cash proceeds) of RM 1,726 million.

(3) In addition, in the January-March quarter of 1942, RM 710 million was received from "business-investment" and "commodity-stocks-replenishment" deposits.

tax produced nearly 70 per cent. of the RM 32.3 milliard received in 1941–42 and accounted for over three-quarters of the increase of RM 14.6 milliard in total taxation receipts since 1938–39.

Other current Treasury receipts in 1940–41, including the war contribution of the local authorities* and net receipts from public enterprises, etc., made up a further RM 3–4 milliard in addition to the revenue shown in the table. For 1941–42 extra income from the "Matrikular" contribution of the Protectorate and the occupation costs from occupied territories were estimated to raise Treasury receipts other than those from taxation to about RM 14 milliard.

Total budgetary expenditure, which must have run fairly closely parallel to total receipts, was thus around RM 90 milliard in the calendar year 1941; of this total about RM 70 milliard was for military purposes (including some

* In addition, a decree of May 1942 provides that local authorities must, for the duration of the war, refrain from increased debt redemption but should utilise liquid resources for the purchase of government securities.

RM 5 milliard allowances to soldiers' families) compared with RM 20 milliard in the last year of peace. Non-military expenditure rose from RM 5.5 milliard in 1933–34 to RM 17.8 milliard in 1939–40 and the Secretary of State at the Finance Ministry stated in September 1941 that it was then at the annual rate of around RM 20 milliard. The increase of civil expenditure since 1933 is due partly to the increased territory of the Reich but mainly to a number of measures taken in recent years: to the increase of the domestic supply of food and raw materials (Four-Year Plan); to the construction of the Reichsautobahnen and improvements in roads and waterways; to the Reich labour service; to the strengthening of the police force and customs frontier guards; to population measures (marriage loans, allowances for children, education grants, etc.); to measures taken to strengthen the sense of German nationality; to the establishment and improvement of cultural institutions; to the increased service of the Reich debt(1); to the erection of a large number of new government buildings; and to the rise in the costs of administration caused by the steady increase of work in various government departments. In the year before the war the Reichsautobahnen and labour service each required about RM 1 milliard while the Food Ministry took nearly RM 2 milliard (compared with RM 250 million in 1933). Part of the increased civil expenditure since 1933 is due also to the concentration of authority in the hands of the central government. In 1928–29 Reich taxation revenue of RM 9.9 milliard compared with an aggregate of RM 4.2 milliard for the states and local authorities; by 1938–39 the figures were RM 17.7 milliard and RM 5.0 milliard respectively; and since then the tax revenue of the Reich has nearly doubled.

A characteristic of German war financing is that about four-fifths of all government borrowing has been made indirectly from institutions, without the issue of large "war loans" offered for public subscription or so-called "savings campaigns" as in other countries. All loans are on tap and the stream of money flows "noiselessly" through a few well-defined channels: short-term borrowing is done to some extent directly from the Reichsbank but principally by Treasury bills taken up by commercial banks; longer-term borrowing is made through Liquidity loans (of 20–30 years) placed directly, somewhat less than half with savings banks and more than half with social funds(2) and private insurance companies, or by marketable Treasury certificates (of 5–21 years) placed largely with the commercial banks. From August 1939 to December 1941 the total Reich debt rose by RM 93 milliard: RM 4½ milliard represents the short-term debt to the Reichskreditkassen ("sundry loans" in the table), an external source of financing, while RM 2½–3 milliard of Treasury bills and certificates have been taken up by the central banks and credit institutions in the Protectorate and neighbouring countries. This leaves RM 86 milliard financed within Germany (RM 47 milliard

(1) Unofficially estimated at RM 3¾ milliard, with an average interest rate on the total outstanding debt at a little over 3 per cent. (Die Deutsche Volkswirtschaft, Nr. 6, of February 1942.)

(2) Contributions for unemployment insurance, which have been maintained, averaged RM 1.5 milliard in the years 1934–37 and RM 2–3 milliard in 1938–41; for 1942, RM 2.7 milliard is expected. This revenue, which flows to the "Reich fund for the utilisation of labour" (Reichsstock für Arbeitseinsatz) serves primarily for the regulation of the labour market, for the provision of work and for allowances to persons liable to labour service. In the years 1935–39, RM 2 milliard out of the RM 3 milliard subsidies received from the Reich in times of heavy unemployment were repaid. Further, a fund is being built up which is partly invested in Reich securities.

at short term, including tax certificates, and RM 39 milliard at middle and long term). Of this RM 86 milliard it has been estimated that RM 17–19 milliard was purchased directly by the public(1). The amount taken by the banks is indicated approximately by the increase of their deposits by, say, RM 45 milliard over the same period (RM 25 milliard of savings deposits and RM 20 milliard of other deposits); to this must be added RM 12½–13½ milliard working credit and Treasury bills taken up by the Reichsbank and RM 1 milliard credit from the Rentenbank, giving nearly RM 60 milliard from the banking system as a whole. Further, insurance companies and social funds are estimated to have provided some RM 7–9 milliard.

A disadvantage of government borrowing from institutions is that, except for life assurance premiums and contributions to social funds, the original individual subscriber does not have his money as effectively tied up as in a long-term public loan. As shown by figures previously given, over one-half of the Reich debt placed internally during the war was with commercial banks and savings institutions whose deposits are at sight or at various terms of notice up to twelve months. These deposits have risen considerably since the war, as a direct result of the "noiseless" method of financing. In the closing months of 1941 two new forms of investment were introduced which had the effect of tying up the original subscriptions until after the end of the war:

A. "Iron savings" are open to German wage and salary earners and regular payments are made through the intermediary of the employer, who directly deducts the amounts due on pay day and transfers them en bloc to the local savings bank (or other credit institution). Amounts saved are limited to RM 26 a month (50 per cent. higher for workers doing specially paid work), while wage bonuses may also be invested. These savings may be withdrawn only on one year's notice after the war. They receive interest at the rate for one-year savings deposits, currently 3¼ per cent., interest being withdrawable. The great advantage to the saver lies in the exemption from all Reich taxes and social contributions. Thus, in the example officially given, a bachelor with a wage of RM 300 a month who "iron-saves" RM 26 gains a tax exemption of RM 11 and thus receives in actual cash only RM 15 less than before. In other words, for every RM 15 iron-saved from his **cash** income monthly he is credited with RM 26, i. e. is given a bonus of 73.3 per cent. and is paid interest at a flat rate of 5.63 (3.25×1.73), a total remuneration, *in interest and capital value ultimately* due, of nearly 80 per cent. in the first year. This is a particularly favourable example for the saver, the tax exemption varying in general from about 10 to 15 per cent. of the amount saved, i. e. the average remuneration of iron savings is probably around 15–20 per cent. in the first year. By the end of March 1942 iron savings had produced RM 250 million.

---

(1) Deutsches Institut für Wirtschaftsforschung, 31st March 1942. A somewhat lower figure is given by "Bank Archiv", 15th June 1942, which estimates RM 10–11 milliard for the two-year period January 1940 to December 1941 (barely RM 4 milliard in 1940 and RM 6–7 milliard in 1941). Moreover, the bulk of these securities were taken as investments by enterprises and only a relatively small part by private individuals.

B. The class of investment open to entreprises is in two forms, "business-investment" deposits (Betriebsanlage-Guthaben) and "commodity-stocks-replenishment" deposits (Warenbeschaffungs-Guthaben).

Business-investment deposits may be made at the Treasury by industrial and other entreprises up to one-half of the value at which movable working equipment subject to wear and tear was assessed for the fiscal year 1940. These deposits, which will be repaid on application after the war, are non-interest-bearing for the duration of the war but, if maintained after the war, will become interest-bearing. Depositors will be granted the privilege of not being required to include in their tax returns after the war a valuation of purchases made up to the amount of the sum deposited. These deposits may be transferred, but it is not expected, or desired, that any considerable market will spring up. It is not possible to give any accurate estimate of the rate of remuneration of these deposits since it depends upon two unknowns: the length of the war (for which period interest is sacrificed) and the level of post-war taxation.

Commodity-stocks-replenishment deposits are somewhat similar in nature to those described above, but they are intended to apply to funds released by the utilisation of stocks of raw materials, semi-finished and finished goods which cannot be replaced, and thus appeal particularly to commercial firms (although it is of course possible for one entreprise to be eligible for both forms of deposit). These deposits are limited in amount to one-fifth of the valuation of raw materials and other stocks as assessed for taxes in 1938 (or for the average of 1937–39). Taxation privileges are given for the rebuilding of commodity stocks in the years after the war.

The first tranche of entreprises' deposits paid to the Treasury by 10th January 1942 produced RM 710 million (nearly RM 550 million of which was in the form of business-investment deposits). A second tranche was paid in up to 10th April 1942. For these deposits and for iron savings, arrangements may be made for repayment before the end of the war in exceptional cases of need.

Iron savings are designed for those workers having the greatest surplus of currently-earned purchasing power (although these workers may draw on their ordinary savings deposits for current expenses) and the money is lent indirectly to the government through the medium of a credit institution. The deposits of entreprises, on the other hand, appeal to surplus funds already in existence and are lent directly to the Treasury. As the funds were previously held largely as commercial-bank deposits or invested in Treasury certificates, the operation is essentially a transfer from a realisable to a blocked investment.

Short-term issues have risen more rapidly than long and middle-term loans since the beginning of the war and at the end of 1941 accounted for one-half of the Reich internal public debt. Over 90 per cent. of the short-term debt consists of Treasury bills (Reichswechsel and Schatzanweisungen). Of the RM 24.5 milliard new Treasury bills issued during 1941, at least RM 6.2 milliard were taken up by the Reichsbank (since it is possible that some of the "special bills", which constituted by far the greater part of the bill portfolio at the outbreak of the war, have been redeemed contractually and replaced by Treasury bills), compared with RM 4.0 milliard in 1940.

German Reichsbank Return.

At end of month in millions of RM	Assets			Liabilities	
	Bills and cheques	Securities	Sundry assets	Notes	Deposits etc.
1938 December . .	8,244	855	1,488	8,223	1,527
1939 December . .	11,392	1,197	2,033	11,798	2,018
1940 December . .	15,419	389	1,726	14,033	2,561
1941 March	15,367	385	1,246	14,188	2,127
June	16,258	461	1,879	15,565	2,373
September .	18,016	406	1,866	16,918	2,511
December . .	21,656	391	2,085	19,325	3,649
1942 March	21,673	298	1,269	19,774	2,762

All other assets showed little change on the year. The item "sundry assets", under which is booked the direct working advance of the government, fell below RM 1 milliard early in 1942, a low level unattained for several years.

The note issue rose by RM 5.3 milliard, against RM 2.2 milliard in 1940, while deposits at the Reichsbank grew by over RM 1 milliard (more than 40 per cent.) to the record high level of RM 3.6 milliard, reflecting the liquidity of the market, particularly of the commercial banks, as is shown also in the table on the next page.

Deposits at the big Berlin banks rose in 1941 by RM 3 milliard and at the four special banks by RM 4 milliard, the total increase of RM 7 milliard comparing with RM 5½ milliard in 1940. Against this the chief movement on the assets side in 1941 was the growth of the portfolio of Reich securities by RM 6½ milliard. Business advances increased somewhat in the last months of 1941 for reasons connected with the extension of the war economy (although declining relatively to the volume of government securities held); a further increase of business credits is foreshadowed owing to a change in the technique of financing government armaments orders, payments in advance being gradually reduced so that contractors are forced to utilise their own liquid funds and ultimately to seek credit at the banks.*

Deposits with the savings banks, which accounted for three-quarters of all savings deposits in the country, were rising at the annual rate of about 10 per cent. before the war and reached RM 21½ milliard at the end of 1939 (including RM 2 milliard on account of the incorporation of the Austrian savings-bank organisation). Semi-official announcements placed the increase of savings deposits at RM 6½ milliard in 1940 and nearly RM 10 milliard in 1941, that is by about 30 and 36 per cent. respectively in the two years.

* If the average advance payment were reduced from 50 to 25 per cent., it is unofficially estimated that some RM 3½ milliard of government outlay would be postponed for a few months, with an approximately corresponding reduction of government expenditure in the current year.

German Bank's Balance Sheets.

At end of year in millions of RM	Assets							Total of balance sheet	Liabilities
	Cash	Business advances etc.	Bills	Reich securities			Other securities		Deposits etc.
				Treasury bills	Bonds and certificates	Total			
Five big Berlin banks (1)									
1929 (4)	2,271	8,116	2,659	447	16	463	371	14,220	12,410
1937	631	3,145	2,541	407	437	844	561	8,071	6,782
1938	751	3,365	2,146	1,229	603	1,832	547	9,012	7,627
1939	741	3,495	2,039	2,627	347	2,974	520	10,143	8,804
1940	886	2,748	2,167	5,139	1,171	6,310	527	12,995	11,699
1941	1,005	3,081	2,166	7,043	1,791	8,834	479	15,927	14,623
Four special banks (2)									
1937	396	208	1,318	576	459	1,035	69	4,011	2,855
1938	478	261	1,476	757	458	1,215	75	4,438	3,313
1939	474	325	986	3,089	374	3,463	81	6,222	5,129
1940	558	507	1,504	4,721	762	5,483	66	8,931	7,873
1941	674	733	1,036	8,371	1,183	9,554	111	12,851	11,823
Total nine banks (3)									
1937	1,027	3,353	3,859	983	896	1,879	630	12,082	9,637
1938	1,229	3,627	3,622	1,986	1,061	3,047	622	13,450	10,940
1939	1,215	3,820	3,025	5,716	721	6,437	601	16,365	13,933
1940	1,444	3,255	3,671	9,860	1,933	11,793	593	21,926	19,572
1941	1,679	3,814	3,202	15,414	2,974	18,388	590	28,778	26,446

(1) Deutsche Bank, Dresdner Bank, Commerz Bank, Reichskreditgesellschaft and Berliner Handelsgesellschaft. In 1929 seven banks (i. e. including the Darmstädter und Nationalbank and the Barmer Bankverein).

(2) Deutsche Girozentrale, Preussische Staatsbank, Deutsche Zentralgenossenschaftskasse and Bank der Deutschen Arbeit.

(3) In 1937 and 1938 the five Berlin banks accounted for slightly under 30 per cent. of the total resources of the monthly reporting banks, and the four special banks for nearly 15 per cent. The special banks increased their relative importance in the following years (especially the Bank der Deutschen Arbeit); for 1941 the nine banks probably controlled about 60 per cent. of the resources of the reporting banks (which had total deposits of, say, RM 40–42 milliard at the end of the year, compared with RM 21 milliard when the last publication was made in July 1939).

(4) The year 1929 is given for comparison. Deposits with the Berlin banks are now higher than in 1929 (when the total included foreign deposits): the increase of RM 8 milliard in the past four years has been entirely against Reich securities. In 1929, Reich securities amounted to 4 per cent. of deposits, and total business credits (including commercial bills) to 80 per cent.; by 1941, Reich securities (to which should be added 70–80 per cent. of the bill portfolio) had risen to over 70 per cent. of deposits, and business credits (including the remainder of the bill holding) had fallen to 25 per cent.

These figures exclude the giro and other accounts at the savings banks, which probably amounted to some RM 7 milliard at the end of 1941, thus making the total of all deposits at the savings banks around RM 45 milliard.

The money market was very liquid during the year and there was little change in interest rates. Bank rate remained at 3½ per cent., to which it had been reduced in April 1940; but, whereas the private discount rate was lowered three times in 1940, only a single reduction of $^1/_8$ per cent. to $2^1/_8$ per cent. was made during 1941 (on 3rd June). Commercial bills, to which this rate applies, had a circulation which was estimated at under RM 1 milliard before the war and has probably declined since then. Three-month Treasury bills (Reichswechsel), issued at the private-discount middle rate, came to the fore during the year, owing partly to a modification of the terms of issue which made them redeemable at any date desired, while Solawechsel of the Golddiskontbank, issued at the private-discount higher rate, declined in importance. The other form of Treasury bills (unverzinsliche Schatzanweisungen) are in two series: the discount on both series was reduced by $^1/_8$ per cent. in June 1941, the six-month bills to $2^3/_8$ per cent. and the longer bills to $2^7/_8$ per cent. (while the maturity of these bills was lengthened from 17–18 to 20–21 months). The narrowing of interest-rate margins presses heavily on bank profits and has forced some further measures of rationalisation, including the closing of redundant offices and certain administrative economies. Some relief was given, however, by the increase of turnovers and in 1941 by the growth of foreign business. From 1st April 1942 bank commission on credit granted was reduced from $^1/_8$ to $^1/_{12}$ per cent. monthly, so that bank advances will be cheapened for borrowers by ½ per cent. per annum, that is, generally from 6 to 5½ per cent. (and for overdrafts from 9 to 8½ per cent.).

On the long-term market the lowering of interest rates made further progress during the year. Treasury certificates, which were placed at 4½ per cent. before the war and at 4 per cent. in 1940, were successfully issued at 3½ per cent. in 1941. Five tranches were issued during the year, the maturities being lengthened from 14½ to 20½ years while the issue price was raised from 98¾ to 99. On 1st August 1941, the earliest maturity date, the RM 300 million 5 per cent. loan of 1927 was repaid, this being the last remaining internal loan bearing interest above 4½ per cent. Of the thirteen issues of 4½ per cent. Treasury certificates totalling RM 12,500 million, some RM 1,650 million of the 1937 series are callable in 1942 (and have been called for May and August for conversion into 3½ per cent. issues), while RM 6,800 million issued in 1938 are callable in 1943.

Savings banks, more dependent upon long-term rates and with relatively less expenses than the commercial banks, have maintained their ordinary deposit rate at 2½ per cent. (3¼ per cent. for money at one year's notice). But life assurance companies have been vitally affected by the continuously falling average yield on their investments over recent years, and a reduction in the basic rate for actuarial calculations to 3 per cent. (previously 3½–4 per cent.) was decreed at the end of 1941. The companies continue to reduce the distribution of bonuses on old policies, while higher premiums are payable for new business.

Advantage was taken of market conditions in 1941 to make a large number of conversions; of the total involved, some RM 10 milliard, about RM 7½ milliard were 4½ per cent. mortgage bonds, other conversions affecting the loans of local authorities and industrial debentures. The interest reduction was generally from 4½ to 4 per cent., although a few loans (about RM 350 million) were converted to a 3½ per cent. basis. In December 1941 a decree was published providing a simplified technical procedure for the conversion of further 4½ per cent. mortgage bonds to a 4 per cent. type; the reduction of interest takes place from 1st April 1942, while from 1st July 1942 the banks will lower their rates for advances made from the proceeds of mortgage bond issues. These conversions involved no fresh subscriptions. The simplified procedure for conversion was later extended to the bonds of local authorities. New industrial bond issues fell to RM 535 million in 1941 against RM 883 million in 1940, the interest rate being generally 4 per cent. against 4½ per cent.

Alsace and Lorraine have separate budgets. The first civil budget, for the year 1941–42, gives total estimated expenditure in Alsace at RM 409 million, of which RM 194 million was for reconstruction and the betterment of conditions resulting from the war. The budget in Lorraine for 1941–42 provided RM 300 million for reconstruction. In the Governor-Generalship of Poland the ordinary budget for 1940–41 totalled around Zl. 1,000 million, to which an extraordinary budget of Zl. 278 million was added; gross tax receipts, which amounted to Zl. 391 million in 1940–41, had risen to Zl. 310 million for the first half of 1941–42.

From October 1940 the Protectorate of Bohemia and Moravia came within the German customs area and foreign exchange restrictions with Germany were abolished; and from 1st April 1941 the National Bank of Bohemia and Moravia was included in the Reichsbank giro system, thus working, in effect, as an extension of the Reichsbank, with the additional task of a conversion office (changing Reichsmarks into Protectorate crowns).

National Bank of Bohemia and Moravia.

At end of month in millions of Kronen	Assets			Liabilities		
	"Sundry assets"	Internal credit	Gold and foreign exchange	Note circulation	Current accounts etc.	"Kassenscheine"
1938 December .	1,045	3,550	3,942	6,950	656	395
1939 December .	3,791*	1,896	2,402	6,345	1,054	525
1940 December .	7,816	24	2,232	6,453	1,560	1,002
1941 March . . .	8,444	250	2,234	7,007	2,051	1,320
June	8,939	660	2,291	7,101	2,091	1,731
September .	10,428	840	2,299	7,888	2,869	1,796
December .	12,957	840	2,300	9,398	2,800	1,842
1942 March . . .	12,735	840	2,291	9,755	2,943	1,837

* Of this amount K. 2,831 million was shown in the balance sheet to represent claims on Germany on account of Reichsmark note and coin holdings (K. 636 million) and other floating assets (K. 2,195 million).

"Sundry assets", in which Reichsmark balances and investments preponderate, rose by over K. 5,000 million in 1941 to nearly K. 13,000 million, an amount considerably exceeding the total note issue, which rose in 1941 by less than K. 3,000 million. The liquidity of the market is indicated by the rise of current accounts (part of the commercial banks' cash reserves) and by the increased circulation of "Kassenscheine" issued by the National Bank since the second half of 1938 to mop up surplus floating funds.

The bill portfolio of the commercial banks, almost exclusively Reich Treasury bills, increased by nearly K. 3,000 million (say, RM 300 million) in 1941 and the security holding by K. 1,270 million (as a result of Protectorate loans floated to cover the Matrikular contribution to the Reich). Current accounts with the eight banks rose by K. 3,870 million and savings accounts by K. 580 million. In the last quarter of 1941 advances (to the private economy of the country) rose, for the first time since 1939, by over K. 700 million; during the year balances with banks in the Reich were transferred from this item to the "cash" holding, as shown in the following table.

Bohemia and Moravia
Commercial banks' balances sheets [1].

At end of month in millions of Kronen	Assets				Total of balance sheet	Liabilities	
	Cash	Bills	Advances etc.	Securities		Current accounts etc.	Savings accounts
1939 December.	2,694	1,440	8,757	3,356	17,970	11,068	4,857
1940 December.	2,803	3,953	7,754	3,951	20,185	13,255	4,698
1941 June . . .	2,742	6,037	7,182	4,545	22,299	15,281	4,751
September	3,641	7,151	6,991	4,549	24,184	16,846	4,890
December.	3,162	6,926	7,710	5,224	24,910	17,129	5,274

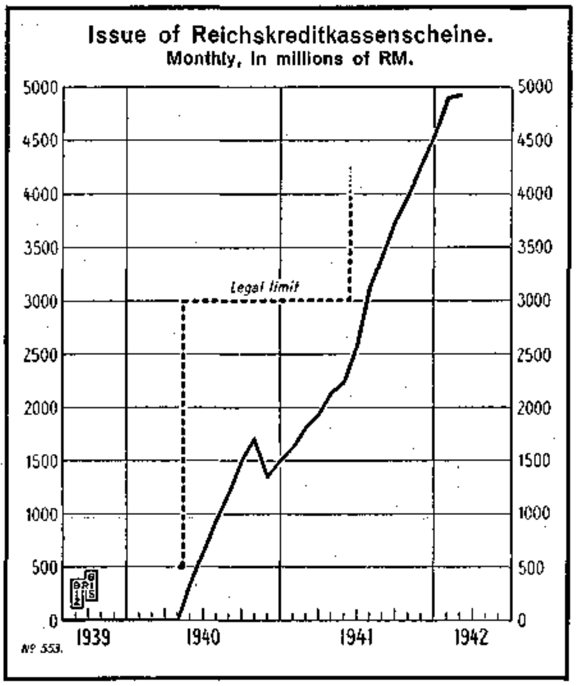
(1) Eight banks, viz. Gewerbebank, Prager Creditbank, Böhmische Industriebank, Mährische Bank, Agrarbank, Böhmisch-Mährische Bank, Böhmische Escomptebank and Böhmische Union Bank: the last two banks, which are under German direction, held one-half of the aggregate bill holding at the end of 1941 against one-quarter at the end of 1939.

The liquidity of the market permitted considerable issues on government account during the year. In January 1941 the commercial banks took up K. 600 million $3\frac{1}{2}$ per cent. 15-year Kassenscheine, and a $4\frac{1}{2}$ per cent. 50-year loan of K. 400 million was placed with insurance companies; a little later a $3\frac{1}{2}$ per cent. 1942–46 issue was placed for K. 1,500 million: in May, for the first time, a $3\frac{3}{4}$ per cent. 50-year issue for K. 1,200 million was issued on the open market at 99.7; and in December it was possible to place a $3\frac{1}{4}$ per cent. 50-year loan for K. 3,000 million at par. On the short-term market there has been no appreciable change since 1st October 1940, when the National Bank's discount rate was adjusted upwards from 3 to $3\frac{1}{2}$ per cent. to conform with German rates, and other short-term rates were also brought into line.

Reichskreditkassenscheine issued by the Reichskreditkassen are German government notes denominated in Reichsmarks for use in the occupied territories, particularly by the German army. They were first put into circulation in Poland in 1939, but the issue was small and they were soon withdrawn. In 1940, they were issued in Denmark, Norway, Holland, Belgium and France: in 1941, the issue took on a great extension, especially after the opening of the Russian campaign, and in August, when a second representative of the German High Command was appointed to the administrative board of the Reichskreditkassen in Berlin, the previous legal limit of RM 3,000 million was removed.

By the end of 1941, there were in all 63 Kassen open; 23 remained from the 1940 campaign (Holland 1, Belgium 4, Luxemburg 1 and in the occupied zone of France 17) and 40 as a result of the extensions in 1941 (Croatia 1, Serbia 1, Greece 2, Bulgaria 1, Roumania 1, and 2 in Bessarabia, 11 in the former Baltic States, 6 in eastern Poland and 15 in occupied Russian territory). In Bucarest and Sofia only liaison offices were opened, the troops being paid partly in the local currency and partly in "canteen money", which could be used solely for the purchase of army supplies. But in the occupied eastern countries the Reichskreditkassen have had to assume most of the functions of ordinary banks, at least for the time being. Here, as elsewhere, however, the Reichskreditkassenscheine in circulation will be replaced by local currencies, so that an eventual separation of these currencies and the Reichsmark will present no particular difficulties.

The following graph shows the expansion of the item "Sundry short-term loans" in the debt statement of the Reich, this being the item under which the debt to the central management of the Reichskreditkassen on account of the issue of Reichskreditkassenscheine is booked.



The loan from the Reichskreditkassen first appeared in the Reich public debt statement for May 1940. The graph shows that from the middle of 1939 to April 1940 the item "Sundry short-term loans" hardly moved from RM 5 million. Other items besides the Reichskreditkassen debt are likely to be small and transitory and the curve may be taken to indicate the total issue of Reichskreditkassenscheine.

The proportion of Reichskreditkassenscheine issued in the various countries is not known, nor is much information available as to their withdrawal. Certain amounts have been exchanged by the central banks of the occupied countries against the local currency: Scheine are thus withdrawn from "circulation", but so long as they figure as a German debt in clearing or other accounts they remain "issued" in the technical sense. The actual "circulation" in the countries occupied in 1940 is now very small although the Scheine retain their legal-tender status. Their withdrawal from "circulation" in Belgium, for example, is indicated by the account of the Reichskredit-kassen at the Bank of Issue in Brussels ("Compte d'échange de Reichskreditkassenscheine"), which had risen by August 1941 to slightly more than B.fcs 3,500 million (the equivalent of RM 280 million) and has since stood practically unchanged.

In France, on the other hand, nearly Fr.fcs 12 milliard (the equivalent of RM 600 million) were redeemed out of the sums paid by the French Government to cover occupation costs up to December 1940. These Scheine were withdrawn not only from circulation but also from the total issue, i. e. cancelled, without any remaining debt of the Reichskreditkassen. The net fall in the total issue by RM 350 million in November 1940, as shown in the graph, reflects this cancellation in France. In Luxemburg (January 1941) and in Alsace-Lorraine (March 1941), the Scheine were withdrawn and ceased to be legal tender: these issues having been exchanged for Reichsbank notes, the issue has no doubt been cancelled, as in France. The actual "circulation" in all countries is reliably reported* to have fallen to about RM 400 million at the end of April 1941, compared with a maximum of around RM 1,000 million in the autumn of 1940. This earlier maximum was doubtless exceeded in the autumn of 1941.

* In an article by M. Kretzschmann, a member of the Reichsbankdirektorium, in "Deutsche Geldpolitik" (Schriften der Akademie für Deutsches Recht).

At the end of 1941, the total "issue" of Reichskreditkassenscheine outside Germany was RM 4,500 million, nearly one-quarter of the circulation of Reichsbank notes inside Germany. Stringent foreign exchange restrictions have been imposed between the German army abroad and the home country to prevent the issue of Reichskreditkassenscheine from endangering the stability of the Reichsmark. In certain cases, hoarding of these Scheine by the public has somewhat impeded the conversion into local currencies.

Italian budget accounts up to the financial year ending 30th June 1940 are summarised in the table below.

Italian Budget Accounts
1934-35 to 1939-40.

Year ending June in milliards of lire	Expenditure			Ordinary revenue	Deficit
	Military	Other	Total		
1934-35 . .	5.2	15.6	20.8	18.8	2.0
1935-36 . .	12.6	20.4	33.1	20.4	12.7
1936-37 . .	16.6	24.4	40.9	24.7	16.2
1937-38 . .	13.3	25.4	38.6	27.5	11.2
1938-39 . .	15.0	24.8	39.9	27.6	12.3
1939-40 . .	27.7	32.7	60.4	32.4	28.0
Totals. . .	90.4	143.3	233.7	151.4	82.4

Note: Ordinary and extraordinary expenditures are combined in the table. Of the military expenditure, Lit. 47.7 milliard was classed as ordinary and Lit. 42.8 milliard as extraordinary. Of the "other" expenditure in the table, Lit. 24.3 milliard was extraordinary (making the total extraordinary expenditure Lit. 67.0 milliard) and includes the outgoings of the important Ministry for Italian Africa. "Other" expenditure also covers Lit. 6.9 milliard for interest service on the debt in 1939 and Lit. 8.0 milliard in 1940; budget estimates place the interest service at Lit. 10.0 milliard for 1941-42 and Lit. 13.9 milliard for 1942-43. The rise in ordinary revenue reflects the increases of taxation up to the war, and further increases have since been made.

Over the six-year period the aggregate deficit was about Lit. 82 milliard. Long and middle-term issues amounted to Lit. 39.8 milliard, while Lit. 26.0 milliard was raised by short-term borrowing (16.7 milliard by one-year Treasury bills, 2.5 milliard by the issue of government notes and 6.8 milliard on current account from the Cassa dei Depositi e Prestiti and other institutions); in addition, the unpaid liabilities (or arrears of expenditure) of the government grew by Lit. 13.4 milliard to Lit. 16.0 milliard in June 1940 (the month when Italy entered the war). The increase of these unpaid liabilities of the government led to a system whereby government payments were spread over a number of years.

For the financial years 1940-41 to 1942-43 budget estimates are available and are shown in the table. According to these figures rather over two-thirds of Italy's budget expenditure would be covered by credit operations and under one-third by taxation. From statements made by the Finance Minister it is known that in the first eight months after June 1940 (July 1940 to February 1941) the deficit was Lit. 45 milliard (an average of Lit. 5,625 million monthly) and for the fifteen and a quarter months to 8th October 1941 it was Lit. 76 milliard (an average of Lit. 4,275 million monthly for the seven and a quarter months

Italian Budget Estimates
1940-41 to 1942-43.

Year ending June in milliards of lire	Total expenditure*	Ordinary revenue	Deficit
1940-41	94.9	29.0	65.9
1941-42	96.0	31.1	64.9
1942-43	108.8	35.4	73.4

* For 1941-42 and 1942-43 military expenditure probably amounts to about Lit. 60 milliard.

March to 8th October 1941), the average monthly expenditure for the whole period being slightly under Lit. 5,000 million. For the eighteen months of warfare up to the end of 1941 the deficit on this basis would be nearly Lit. 90 milliard, i. e. higher than the aggregate deficit for the previous six years.

The greater part of the Lit. 76 milliard deficit from 1st July 1940 to 8th October 1941 was financed as follows:

	In milliards of lire	
Two war loans (issued in February and September 1941) of 5 per cent. nine-year bonds gave in new money	over	34.0
Further instalment on Real Estate loan		0.2
Ordinary Treasury bills (of one to twelve months)	about	21.0
Current-account advances from Cassa Depositi e Prestiti (and other institutions)	over	10.3
Advances from the Banca d'Italia		7.4
Total	say	73.0

Part of the balance was covered by the issue of small government notes (Lit. 500–1,000 million). In addition to bringing in new money, the two war loans covered about Lit. 5 milliard of conversions of the floating debt.

The unpaid liabilities of the government are normally refinanced by borrowing from the Banca d'Italia. Previously, for the financing of public works, especially those connected with land reclamation, the Treasury had been authorised to issue special 30-year credit certificates, which were placed with the Consortium for the Support of Industrial Securities* and other credit institutions, the proceeds being utilised to compound payments spread over a number of years. Creditors on account of war supplies have now been enabled to mobilise their claims on the government, under special conditions and up to certain amounts, through the discount of promissory notes, secured by the cession of the claims, at the Consortium, which rediscounts them at the Banca d'Italia. A decree of 13th January 1941, extending previous provisions, authorised the military administration (army, navy and air force) to spread payments for current contracts in excess of Lit. 5 million and new contracts in excess of Lit. 20 million over periods not exceeding ten years. These deferred annuities bear interest at ½ per cent. above the official bank rate but can be rediscounted at the Consortium at the same rate by the cession of special certificates issued by the administration concerned; for firms which retain the certificates, a further ½ per cent. is added. For 1941 a consortium of armament firms was set up to facilitate the intermediary financing of government orders (the Ente Finanziamenti Industriali with an initial capital of Lit. 100 million, later raised to Lit. 300 million).

Banca d'Italia Balance Sheets.

At end of year in millions of lire	Assets				Total of balance sheet	Liabilities	
	Gold	Bills	Advances	Advances to government		Notes	Current accounts and sight bills
1937 . .	3,996	2,544	4,508	1,000	21,452	17,468	1,465
1938 . .	3,674	3,704	3,687	3,000	23,598	18,955	1,721
1939 . .	2,738	4,833	2,991	9,000	29,617	24,432	2,486
1940 . .	2,282	4,833	3,442	16,000	39,182	31,306	5,239
1941 . .	.	5,625	5,796	.	.	.	.

* The Consorzio per sovvenzioni su valori industriali is an independent department of the Istituto Mobiliare Italiano (of which the Governor of the Banca d'Italia is Chairman).

The latest information published on the situation of the Banca d'Italia is given in the table on the preceding page. Direct advances to the government rose by Lit. 7 milliard in 1940. As regards 1941, the Governor of the Banca d'Italia stated at the annual general meeting that central-bank credit covered only one-eighth of government expenditure. Credit granted by way of bills and advances amounted to over Lit. 3,000 million in 1941 compared with Lit. 450 million in 1940.

In 1941, deposits and current accounts with the three large Italian commercial banks rose by Lit. 6.6 milliard, more than double the expansion of 1940.

Italian Banks' Balance-sheet Items*.

At end of year In millions of lire	Assets				Total of balance sheet	Liabilities		
	Cash (1)	Bills (2)	Advances and over-drafts (3)	Govern-ment securities (4)		Current accounts and corres-pondents	Time and savings deposits	Total deposits etc. (5)
1938	1,961	10,139	5,917	1,437	21,751	11,978	5,376	17,353
1939	2,537	10,491	6,626	1,560	23,717	12,869	5,968	18,837
1940	2,635	12,812	7,408	1,355	27,472	14,333	7,353	21,686
1941	2,762	14,711	11,309	2,083	35,210	19,098	9,154	28,252

* Three "banks of national interest": Banca Commerciale Italiana, Credito Italiano and Banco di Roma.
(1) Cash and deposits at other banks.
(2) Discounts of commercial and Treasury bills and sight credits.
(3) Advances, debtor current accounts and correspondents.
(4) Government and government-guaranteed securities.
(5) Deposits, including savings accounts, current accounts and correspondents.

The greater part of the increase of deposits and current accounts was due to the expansion of advances by Lit. 3.9 milliard; this reflects the demands for credit arising from current war production (the financing of completed orders being taken over by the Consorzio, as mentioned above). The rise of government long-term securities, by Lit. 0.7 milliard, and of bills (including Treasury bills), by Lit. 1.9 milliard, played a much smaller rôle. As the total issue of Treasury bills increased on an average by Lit. 1.4 milliard a month, it appears that only a small proportion was taken up by these banks.

In addition to the three banks shown in the table, the Banca Nazionale del Lavoro should be mentioned. This bank has had special tasks to perform in connection with the financing of armaments and of agriculture, the remittances of Italian workers in Germany, etc. The balance-sheet total of this bank rose by 67 per cent. from Lit. 8.7 milliard in December 1940 to Lit. 14.5 milliard in December 1941, on which date it surpassed each of the three "banks of national interest".

Figures of total savings have been given by the Finance Minister: by June 1941 the total of these savings had risen to Lit. 115 milliard, of which nearly Lit. 100 milliard was directly controlled by the government, Lit. 40 milliard in the postal savings banks, Lit. 26 milliard in banks (Lit. 21 milliard being in the large "banks of national interest"), Lit. 11½ milliard at public institutions and around Lit. 20 milliard at savings banks and mortgage institutions. The government control is exercised through management of the Cassa Depositi e Prestiti, ownership of the Banca Nazionale del Lavoro and (through the Istituto per la Ricostruzione Industriale) a majority shareholding in the three "banks of national interest". At the end of 1941 the total deposits at credit institutions and postal savings banks had risen to Lit. 146 milliard.

Market conditions changed very little during the year: bank rate remained at 4½ per cent. (unchanged since May 1936); the rate for one to two-month Treasury bills was fixed in July 1941 at 3¼ per cent., rising to 5 per cent. for bills of 10–12 months maturity; and the average yield of 5 per cent. rentes fluctuated only between 5¼ and 5½ per cent. The new issues of tax-free 5 per cent. nine-year bonds in February and September 1941 were made at 97½, giving a flat yield of 5.13 per cent.; the yield was 5.40 per cent. if redemption at par be considered and 5.88 per cent. if account be taken of the prizes allotted to each series. In April 1942 a further issue of nine-year bonds with the same conditions produced Lit. 24½ milliard.

For the European countries occupied by German forces, the payment of occupation costs and the domestic financing of clearing and other claims on Germany have been of outstanding importance during the year. Some details published regarding the development of the budgetary and Treasury situation in France are summarised below.

French Budget Accounts.

Calendar year in milliards of Fr.fcs	1941 (realised during year)	1942 (estimates)
Ordinary budget expenditure	100	105½
receipts	72	80
deficit	28	25½
Extraordinary budget expenditure	25	33
Costs of occupation	130	119½
Total deficit	183	178
Financing of clearing account with Germany	12	(25)
Other Treasury charges	8	(10)
Total Treasury credit financing	203	(213)
Borrowing from Bank of France: (1)		
ordinary advances	5	.
special advances	67	.
Other credit financing (2)	131	.

(1) From 26th December 1940 to 24th December 1941.
(2) Difference between total credit financing and the amount borrowed from Bank of France.

Taxation receipts in 1941, at Fr.fcs 72 milliard, were some Fr.fcs 4 milliard above the estimates (while the Caisse Autonome d'Amortissement also had nearly Fr.fcs 2 milliard more than was foreseen). But it was necessary to open supplementary credits, to provide especially for increased salaries and family allowances, so that ordinary expenditure was Fr.fcs 3 milliard higher and the deficit on the ordinary budget Fr.fcs 1 milliard lower than the estimates.

The extraordinary budget, which, besides the cost of liquidating expenses resulting from the war, includes public works for reconstruction, was cut from Fr.fcs 37 milliard to Fr.fcs 25 milliard, largely owing to difficulties of execution, including lack of raw materials, especially in the second half of the year. The costs of occupation, at Fr.fcs 400 million a day, would have been Fr.fcs 146 milliard, but the reduction of payments to Fr.fcs 300 million a day from 11th May 1941 brought the total down to Fr.fcs 122½ milliard, to which were added other expenses such as the cost of billeting etc., which raised the total to Fr.fcs 130 milliard. The financing of the French export surplus to Germany required Fr.fcs 12 milliard and certain traditional charges and advances (railways, post, etc.) a further Fr.fcs 8 milliard.

(The most interesting movements in the estimates for 1942 are the rise of ordinary receipts, due as to Fr.fcs 6 milliard to increases of taxation; the increase of ordinary expenditure, including an expansion of over Fr.fcs 6 milliard in military credits due to rises in pay, the repair of material, construction of barracks and the defensive organisation of overseas possessions; the inclusion of Fr.fcs 3 milliard in the extraordinary budget to subsidise the price of bread; the estimate of occupation costs at Fr.fcs 119½ milliard, i. e. Fr.fcs 109½ milliard at the rate of Fr.fcs 300 million a day plus billeting etc. Finally, on the basis of experience in the first half of 1942, more than Fr.fcs 25 milliard will probably be needed to finance the export surplus on clearing account with Germany, while other Treasury charges may be estimated at Fr.fcs 10 milliard. The total to be financed will thus probably be higher for 1942 than in the previous year.)

Total budget expenditure of Fr.fcs 255 milliard in 1941 was covered as to Fr.fcs 72 milliard, some 28 per cent., by taxation*, leaving a deficit of Fr.fcs 183 milliard, to which must be added some Fr.fcs 20 milliard for other charges, giving a total of rather over Fr.fcs 200 milliard to be financed by the Treasury.

Details of this financing have not been made public but certain indications can be given. Some Fr.fcs 70 milliard were obtained directly from the Bank of France and about Fr.fcs 100 milliard by the issue of Treasury bills (the circulation of which is reported to have risen from Fr.fcs 87 milliard at the end of

Bank of France return.

Near end of month in milliards of Fr.fcs	Assets				Total of balance sheet	Liabilities			
	Gold	Temporary advances to government ordinary (1)	Temporary advances to government special (2)	Other credit items (3)		Note circulation	Current accounts: Treasury (4)	Current accounts: Private (5)	Current accounts: Reichskreditkassen
1938, 22nd December	87	21	—	15	144	109	6	26	—
1939, 21st December	97	32	—	17	168	149	2	13	—
1940, 26th December	85	64	72	17	292	218	1	27	41
1941, 27th March	85	61	100	17	314	228	1	29	54
26th June	85	66	118	15	334	236	1	34	59
25th September	85	65	124	17	342	249	1	27	60
24th December	85	69	139	15	359	267	2	25	62
1942, 26th March	85	67	156	15	375	283	1	30	56

(1) Excluding the permanent advance of Fr.fcs 10 milliard, unchanged throughout the period.

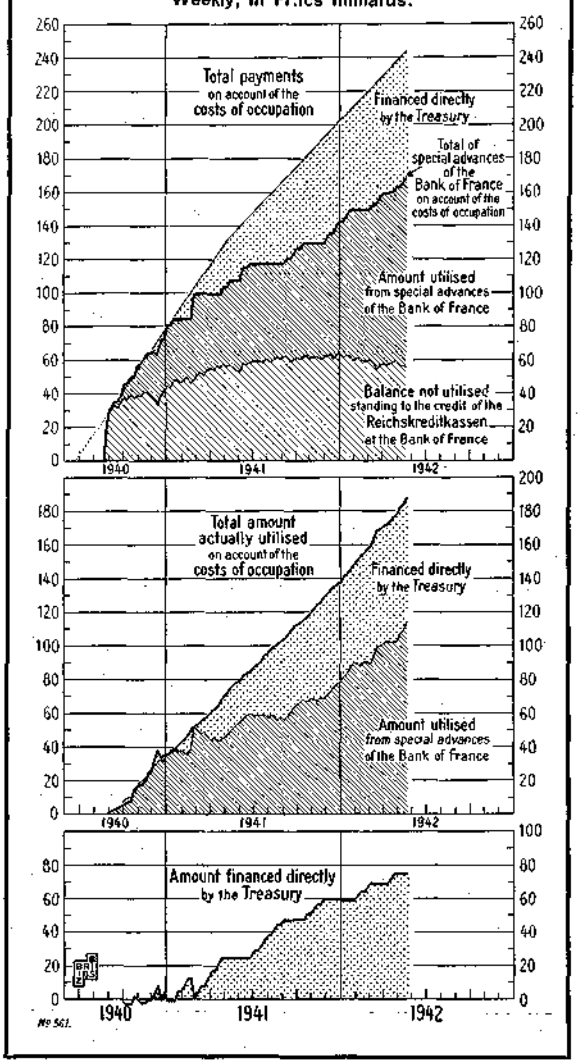
(2) To meet the costs of occupation.

(3) Bills discounted, 30-day and other advances and bills purchased on the market. Commercia bills accounted for only Fr.fcs 1–1¼ milliard of the total bill portfolio in 1941.

(4) Including the account of the Caisse Autonome d'Amortissement.

(5) Including other sight liabilities.

* This is for the central budget only. If account be taken of the Fr.fcs 10 milliard revenue of the Caisse Autonome d'Amortissement, Fr.fcs 15 milliard of local taxation and Fr.fcs 3 milliard income of the Secours National, total revenue would be Fr.fcs 100 milliard against expenditure of, say, Fr.fcs 285 milliard, giving a proportion of 35 per cent. covered by ordinary revenue.



France:
the payment of occupation costs and its financing.*
Weekly, in Fr.fcs milliards.

* The line showing the aggregate of amounts paid on account of the costs of occupation has been drawn assuming regular payments at the rate of Fr.fcs 400 million a day from 25th June 1940 (first payment 25th August 1940), reduced to Fr.fcs 300 million from 11th May 1941. The special advances for the payment of occupation costs and the amount remaining undrawn on the account of the Reichskreditkassen have been taken from the weekly returns of the Bank of France. The amount financed directly by the Treasury is the excess which the aggregate of amounts paid shows above the special advances.
The amount actually utilised is the difference between the aggregate paid and the sum remaining undrawn on the account of the Reichskreditkassen. That the amount financed by the Treasury runs for short periods below zero in the early months reflects the fact that the special advances from the Bank of France exceeded the amount payable on account of occupation costs, this being probably due to initial expenses incidental to the withdrawal of Reichskreditkassenscheine.

1939 to Fr.fcs 164 milliard at the end of 1940 and Fr.fcs 263 milliard at the end of 1941). Of the remaining Fr.fcs 30 milliard, Fr.fcs 12 milliard came from the temporary employment of the cash proceeds of a loan issued by the Caisse Autonome d'Amortissement in October (to be utilised to meet maturities or to convert various categories of short and middle-term securities) and the balance of Fr.fcs 18 milliard was met in other ways. In this connection it may be recalled that by a decree of November 1940 government contracts could be settled up to 50 per cent. of their value by 6-month bills drawn on the Crédit National; in October 1941 the proportion which might be paid in this way was raised to 75 per cent.

The movement of the main items in the return of the Bank of France may be seen from the table on the preceding page.

In 1941 there appears a stagnation of all the asset items except the advances to the government, which rose by Fr.fcs 72 milliard: as Fr.fcs 21 milliard of the amounts paid for occupation costs during the year remained undrawn on the account of the Reichskreditkassen, the *note issue* rose by Fr.fcs 49 milliard (other small movements in the return accounting for the balance).

The amounts paid by the French Government as occupation costs (which exceeded all other budgetary expenditure put together) and their financing, either directly by the Treasury or through the Bank of France, are shown in the graphs above.

The graphs show that Fr.fcs 200 milliard had been paid to the occupying authorities by the end of 1941 (excluding the extra costs for billeting, etc.). Of this amount Fr.fcs 140 milliard had been financed from the special advances of the Bank of France and Fr.fcs 60 milliard directly by the Treasury. Out of the Fr.fcs 140 milliard advanced by the Bank of France, Fr.fcs 60 milliard remained undrawn on the account of the Reichskreditkassen, so that the amount actually utilised from the special advances of the Bank of France on account of occupation costs was Fr.fcs 80 milliard.

Although the rate of payment was decreased from May 1941 the sums actually drawn remained about the same and the amount remaining undrawn on the account of the Reichskreditkassen ceased to grow in the second half of the year. Of outstanding importance for the slowing-up of the credit expansion was the considerable increase of the amount financed directly by the Treasury from March 1941 onwards. Before this date the payment of occupation costs had been temporarily financed from time to time by drawings on the ordinary advances of the Treasury. These ordinary advances had risen to Fr.fcs 69,650 million on 3rd October 1940, and in 1941 fluctuated generally between Fr.fcs 60 milliard(1) and the legal maximum fixed in June 1940 at Fr.fcs 70 milliard. Except for the occupation costs, the budget deficit and other Treasury charges were thus financed (from October 1940 onwards) without any permanent direct utilisation of central-bank credit.

Part of the Treasury financing was effected through the commercial banks. The bill holdings of four big banks rose by Fr.fcs 15½ milliard during the year. As commercial bills have grown scarcer it is probable that the Treasury bill holdings of these four banks (which account for about one-half of the resources of all the banks) rose by more than Fr.fcs 15½ milliard.

France
returns of four big commercial banks.*

At end of month in milliards of Fr.fcs	Assets			Liabilities
	Cash	Bills	Advances and overdrafts	Deposits and current accounts
1938 December	3.9	21.3	7.7	33.6
1939 December	4.9	29.3	8.1	42.1
1940 December	6.4	46.1	8.6	62.0
1941 March	6.2	52.9	8.5	67.7
June	6.3	57.8	8.7	72.6
September	6.3	60.3	8.2	74.4
December	6.9	61.6	8.5	76.7
1942 March	7.2	62.5	9.7	78.8

* Crédit Lyonnais, Comptoir National d'Escompte, Société Générale, and Crédit Industriel et Commercial.

Cash holdings remained practically unchanged but (as with the capital of the big banks) decreased as a percentage of deposits. The occupying authorities re-established in principle the freedom of transfer in French francs between the occupied and the unoccupied zones in May 1941. But communications remained imperfect on account of limitations in postal traffic, and monetary conditions were more liquid in the occupied zone, where the occupation costs are mainly spent,

(1) Between the 20th and 27th February 1941 the ordinary advances were temporarily reduced from Fr.fcs 64.7 milliard to Fr.fcs 53.1 milliard while the special advances rose from Fr.fcs 84.3 milliard to Fr.fcs 99.3 milliard, an interesting contrary movement indicating a previous current financing of occupation costs from the ordinary advances.

than in the unoccupied territory. Very noticeable is the slowing-down of the increase in deposits of the four big banks: from Fr.fcs 20 milliard in 1940 and Fr.fcs 11 milliard in the first half of 1941 to Fr.fcs 4 milliard in the second half of 1941, a movement which may have its counterpart in the slowing-down of the liquidation of stocks as these near exhaustion.

Savings-bank deposits also rose during the year but at a slower rate, the surplus of deposits over withdrawals being some Fr.fcs 6½ milliard, an increase of, say, 10 per cent. Most remarkable, however, was the growth of the postal cheque accounts (at times at the rate of Fr.fcs 1 milliard a month) continuing a tendency already noticeable before the war. A decree of April 1942 brings postal cheques under the laws regarding bank cheques.

Money market conditions were generally easy. Bank rate was reduced from 2 to 1¾ per cent. on 17th March 1941, while the rate on Treasury bills (of 75 to 105 days) was lowered three times, from 2 per cent. in January to 1⅝ per cent. from September onwards (with corresponding reductions for bills of other maturities). The savings-bank deposit rate, which was lowered from 2¾ to 2½ per cent. in January 1941, was again reduced to 2¼ per cent. in January 1942 (with an extra ½ per cent. on those "stable" deposits which show withdrawals of less than Fr.fcs 8,000 during the year).

On the long-term market also the strength of government rentes was reflected in steadily falling yields. Although the government has issued no long-term loans for new money since the armistice, the opportunity was taken to make a remarkable series of conversion issues. In May 1941 a 4 per cent. 50-year consolidation was made at 99 to cover earlier 6 per cent. loans of the Crédit National (issued in respect of damage resulting from the war of 1914–18) and some Treasury bonds; the Caisse Autonome d'Amortissement made a 4 per cent. 50-year issue at par in October for consolidation and conversion; in November the P. T. T. administration issued a 4 per cent. 30-year loan; and the National Railway Company made two issues of 4 per cent. loans, in June at 95 and in December at 96.6. In all there were five big issues, which covered an aggregate of about Fr.fcs 50 milliard, the economy in interest being estimated at Fr.fcs 550 million. In March 1942 it was possible to lower the interest rate to 3 and 3½ per cent. when two government issues were made to convert earlier loans, with exchange guarantees, amounting in all to Fr.fcs 27 milliard — the largest operation of its kind since 1932. In May 1942 an issue of 4-year 3 per cent. savings bonds was made, interest for the first two years being given as a discount on subscription and for the second two years as a premium on redemption.

A summary of the Belgian budget position and the principal items of official financing are given in the table on the next page.

Budget expenditure as shown in the table rose somewhat on the year; for 1941 it includes various Treasury advances for about B.fcs 2 milliard (of which over one-half went to the National Railway Company). Revenue from

Belgian budget and official financing.

Calendar years in milliards of B.fcs	1940	1941
Expenditure (1)	16.9	20.3
Revenue	7.6	15.5
Excess of expenditure	9.3	4.8
Occupation costs	4.5	16.3
Total budget deficit	13.8	21.1
Clearing account etc.	3.2	8.5
Total to be officially financed by borrowing	17.0	29.6
Method of credit financing (2):		
from central bank	9.3	14.3
from market: short term	5.6	4.7
middle term	—	5.4
long term	0.5	3.5
Total official credit financing	15.4	27.9

(1) All expenditure except costs of occupation.
(2) As shown by public debt returns and statements of the National Bank and Bank of Issue. The total to be officially financed and the actual amount borrowed are not exactly the same for various technical reasons (movement of Treasury balances, differences in date of returns, etc.), but the figures give a close indication. Similarly the amount borrowed from the central bank differs slightly from that shown in the next table.

taxation recovered from the low level of 1940 to B.fcs 12.9 milliard in 1941, while other Treasury receipts, including the repayment of certain advances, raised the total to B.fcs 15.5 milliard, so that the excess of expenditure on this part of the budget was reduced below B.fcs 5 milliard.

Payments to the occupying authorities amounted to B.fcs 16.3 milliard in 1941 (B.fcs 15,152 million actual occupation costs and B.fcs 1,155 million for billeting expenses etc.), while the growth of clearing and similar claims came to B.fcs 8.5 milliard: the addition of these two items raised the amount of official financing necessary in 1941 to nearly B.fcs 30 milliard.

About one-half of the total was covered by the extension of central-bank credit.

In 1941 the Bank of Issue advanced B.fcs 7 milliard to Belgian creditors of Germany on clearing account, while a further B.fcs 1½ milliard claims on Germany accumulated, owing principally to the withdrawal of Reichskreditkassenscheine. This B.fcs 8½ milliard plus B.fcs 5½ milliard odd granted

Belgium — National Bank and Bank of Issue Combined Returns.*

Near end of month in milliards of B.fcs	Assets					Total of balance sheet	Liabilities		
	Claims on Germany			Credit granted			Notes (5)	Current accounts (6)	Postal cheque accounts (7)
	Clearing account (1)	Other (2)	Total	to private economy (3)	to government (4)				
1940 December	0.9	2.3	3.2	1.3	14.0	41.7	34.8	2.6	3.4
1941 March	1.5	3.4	4.9	0.7	15.8	44.5	37.9	2.1	3.5
June	2.3	3.8	6.1	0.5	16.7	46.5	39.9	2.1	3.5
September	5.2	4.1	9.3	0.6	17.5	50.5	44.0	2.0	3.5
December	7.9	3.8	11.7	0.9	19.6	55.5	48.5	2.3	3.7
1942 March	10.1	3.9	14.0	0.8	22.3	60.3	51.9	3.5	3.8

* The principal items omitted from this table are the gold holding of the National Bank at B.fcs 21.7 milliard (all but B.fcs 8 million of which is held abroad) and claims of slightly over B.fcs 1 milliard on the Bank of France. The Bank of Issue is financed by a current advance from the National Bank, of which it thus forms, in practice, a specialised department.
(1) Bank of Issue, "créances en devises étrangères".
(2) Bank of Issue, two accounts of Reichskreditkassen plus National Bank, "monnaies et billets étrangers".
(3) Almost wholly by National Bank.
(4) All from National Bank (including securities purchased on the market) except B.fcs 3,060 million (unchanged) held by Bank of Issue against postal cheque accounts.
(5) Circulation of National Bank, less small amounts held by Issue Bank.
(6) National Bank and Bank of Issue combined. At the Bank of Issue is an account of the Reichskreditkassen.
(7) At Bank of Issue.

directly to the government (against short and middle-term paper) gives a total of some B.fcs 14 milliard new central-bank credit. Almost the whole of this expansion went into the note issue, which increased by B.fcs 13.7 milliard to B.fcs 48.5 milliard, i. e. by nearly 40 per cent., the movement gaining in rapidity in the second half of the year.

As the note issue increased parallel to the expansion of central-bank credit, the position of the commercial banks became tighter during the year. The cash holding was comparatively low in June and September and about B.fcs 1½ milliard bills were rediscounted (or allowed to run off) at the end of the year in order to replenish cash reserves.

Belgian Commercial Bank Returns*.

At end of month in milliards of B.fcs	Assets				Total balance sheet	Liabilities
	Cash (1)	Bills	Advances and over-drafts	Government securities		Current accounts etc. (2)
1939 December .	1.5	2.8	4.8	3.2	20.0	12.7
1940 December .	2.2	6.2	4.6	3.3	22.1	16.1
1941 March . . .	1.7	9.0	4.5	3.2	24.2	18.1
June	0.6	10.1	4.4	3.9	25.0	19.2
September .	0.7	12.0	3.8	3.9	25.9	20.3
December .	2.2	10.4	4.2	3.9	26.4	20.8
1942 March . . .	1.4	12.2	4.1	3.8	27.2	21.6

* Excluding branches and agencies abroad or in the Belgian Congo.
(1) Including balance at National Bank, shown under "Current accounts" in previous table.
(2) At sight or one month's notice plus a small amount (about 10 per cent. of the total) at more than one month.

Advances and overdrafts continued to fall during the year, reflecting the decline of business activity (the increase in the last quarter of 1941 being probably due to fiscal and other reasons). On the other hand, Treasury bill holdings rose from B.fcs 4.4 milliard to B.fcs 9.4 milliard in the year ending December 1941 (when they amounted to 90 per cent. of the bill portfolio) and B.fcs 0.7 milliard of longer-term government securities were taken up in the second quarter of the year. Of the total of B.fcs 13.6 milliard borrowed by the government on the market in 1941, the banks thus took B.fcs 5.7 milliard. At the end of 1939, 70 per cent. of the banks' credits were granted to the private economy of the country and only 30 per cent. to the government; by the end of 1941 these proportions were reversed.

Bank deposits rose by B.fcs 4.7 milliard during 1941, compared with B.fcs 3.4 milliard in 1940; but in 1941 a definite slackening of the rate of growth was apparent, the increase of B.fcs ½ milliard in the last three months of the year being the lowest for any quarter since the occupation. This relative falling-off of commercial-bank deposits was due partly to the issue of government securities to the public but partly also to the preference of the public for bank-notes and for the government-guaranteed deposits of the postal cheque system (private deposits of which rose from B.fcs 3,840 million to B.fcs 5,040 million during 1941). The excess of withdrawals over deposits at the savings banks, however, continued during the year, although at a reduced rate (B.fcs 220 million in 1941 compared with B.fcs 750 and 1,050 million in 1940 and 1939 respectively).

Besides borrowing at the National Bank and the issue of Treasury bills, the principal resources of the Treasury were obtained from two market issues: a 3½ per cent. 5-year tax-free loan issued in two tranches from May to November 1941 produced B.fcs 5,120 million; a 60-year premium loan issued in December produced B.fcs 2,700 million (this loan carrying interest at 3 per cent. for the first five years, at 3½ per cent. for the sixth to tenth years, and at 4 per cent. from the eleventh year onwards).

Since 1st January 1942 payment for goods requisitioned before 29th May 1940 by the Belgian Army, or after that date by order of the occupying authorities, has been made by the Belgian Treasury partly in cash and partly in special 3½ per cent. 5-year Treasury certificates, and this method will be used in all future payments for deliveries and services to the government (except salaries, wages etc.): up to B.fcs 50,000 payments are wholly in cash, but above that amount the following proportions are paid in certificates: 25 per cent. of amounts between B.fcs 50,000 and 100,000, 30 per cent. of amounts between B.fcs 100,000 and 200,000, and 35 per cent. of amounts above B.fcs 200,000. These certificates may, after one year's currency, serve for the payment of taxes.

Market rates were not greatly changed over the year. Bank rate remained at 2 per cent. while the market rate for call money was reduced from 1 to ¾ per cent. in February 1941. Interest on the 4, 8 and 12-month Treasury bills constituting the Independence loan (of January 1940) was reduced twice during the year, in January 1941 from 2.4, 2.7 and 3 per cent. respectively to 2.1, 2.4 and 2.85 per cent., and in May to 1.8, 2.1 and 2.4 per cent. The quotation of the 4 per cent. Unified rente, which had fallen below 70 in 1939, rose from 93½ in the early months of 1941 to 99 at the end of the year, the yield falling from 4.3 to 4.0 per cent.

In 1939 total budgetary expenditure in Holland was around Fl. 1,000 million, while the total government debt rose during that year by Fl. 230 million. Recent details of budgetary expenditure are not available, but it is known that revenue from taxation increased from Fl. 925 million in 1940 to Fl. 1,219 million in 1941, the falling-off of customs duties, particularly since the abolition of the customs frontier with Germany, being offset by increased rates of other taxes. Nevertheless, the deficit rose; this is indicated by the growth of the government debt by Fl. 1,112 million in 1940 and by Fl. 1,527 million in 1941. Government expenditure in 1941 must thus have been running at some Fl. 120–130 million a month above ordinary revenue, an amount which rather exceeds unofficial estimates of the costs of occupation and the expenses of the German civil administration (Fl. 100 million a month).

In addition to the budget deficit, the growth of clearing claims must be taken into account to obtain the total of official financing requirements during the year. The following table shows that these requirements at nearly Fl. 2,500 million in 1941 were more than double the figure for 1940.

Dutch official credit financing.

Calendar year in millions of florins	1940	1941
Central bank –		
direct	168	*(— 248)*
clearing claims etc.	107	945
total	275	697
Market borrowing –		
short term	496	900
middle and long term	448	875
total	944	1,775
Total official credit financing	1,219	2,472

Long-term issues produced a net amount of Fl. 875 million in 1941 and the short-term debt to the market rose by Fl. 900 million, while about Fl. 700 million was obtained by the extension of central-bank credit. Two long-term issues were made in 1941: a 4 per cent. issue at par in January and a 3½ per cent. issue at 97½ in October; these loans brought in Fl. 500 million each. The increase of Fl. 900 million in the short-term market debt was due principally to the issue of some Fl. 670 million Treasury bills (while Fl. 76 million was obtained by small Treasury notes in the form of "silver bonds").

The direct debt of the Treasury to the Nederlandsche Bank was largely repaid during the year, but this was more than offset by the growth of the item "Foreign bills" (the investment of Reichsmark balances in Reich securities) so that the net expansion of central-bank credit for official purposes was about Fl. 700 million.

Nederlandsche Bank Return.

Near end of month in millions of florins	Assets					Total of balance sheet (4)	Liabilities	
	Claims on Germany (1)			Loan to government (2)	Private domestic credit (3)		Notes	Private accounts
	"Sundry accounts"	Foreign bills	Total					
1939 Dec.	29	2	31	83	238	1,431	1,152	229
1940 Dec.	123	15	138	261	211	1,783	1,552	175
1941 March	212	23	235	175	221	1,798	1,593	144
June	219	308	526	76	201	1,908	1,686	154
Sept.	219	590	809	66	177	2,142	1,894	190
Dec.	153	930	1,083	18	165	2,357	2,116	182
1942 March	158	1,128	1,285	*(— 126)*	196	2,573	2,217	168

(1) Except for a small amount indicated by the pre-April-1940 level of these items.
(2) Net, i. e. direct advances plus Treasury bills placed directly with the bank less credit on current account; in March 1942 there was a net credit. Slight differences from the previous table are due principally to the date of the returns.
(3) Excluding Treasury bills placed directly by the government with the bank but including the loan to the Dutch East Indies (reduced from Fl. 61 million to Fl. 55 million over the period shown).
(4) Including, in addition to the specified assets, slightly over Fl. 1,000 million of gold and a small amount of other assets.

In 1941 credits to the private economy of the country declined by Fl. 46 million, the note issue rose by Fl. 560 million, while the private accounts, including the cash reserves of the banks, hardly changed. The rise of the note issue was, indeed, over three times as great as the increase of deposits at the four big Dutch banks during the year; over one-half of this increase was in the second quarter, while in the last quarter a decline took place. These four banks bought nearly Fl. 280 million of the Treasury bills issued to the market. Their Treasury bill holding at the end of 1941 accounted for one-half of the total issue and covered 84 per cent. of their deposits.

Credit conditions were very easy throughout the year, the situation being under the influence of the adjustment of rates down to the German level (an objective which has been surpassed on the short-term market). The fall of long-term yields is indicated by the terms of issue of the two government loans: the October-1941 loan was a 20-year issue with at least 5 per cent. amortisation yearly, giving an average life of at most 10 years and a yield of $3\frac{3}{4}$ to $3\frac{7}{8}$ per cent. A decree of the Finance Ministry in April 1942 placed a minimum rate of 4 per cent. for new mortgage bonds issue (while conversions might take place down to $3\frac{1}{2}$ per cent.). On the short-term market, bank rate was reduced from 3 to $2\frac{1}{2}$ per cent. in June 1941, while the lombard rate remained unchanged; the discount on 3-month Treasury bills fell from $2\frac{1}{4}$ to $1\frac{3}{4}$ per cent. during the year. The rate on savings-bank deposits was maintained unchanged at 3 per cent., but the excess of withdrawals over new deposits at the postal and ordinary savings banks continued, although at a slower rate (Fl. 62 million in 1941 against Fl. 248 million in 1940).

Four large Dutch banks principal items.

At end of month in millions of florins	Assets		Liabilities
	Advances and overdrafts	Treasury bills	Deposits
1939 December	378	202	576
1940 December	286	517	756
1941 March	313	514	768
June	238	709	873
September	212	838	956
December	222	793	941
1942 March	186	907	992

Danish budgets have shown a small excess of revenue in recent years, the surplus of D.Kr. 57 million in the year ended March 1941 bringing up the budgetary reserve above D.Kr. 100 million. But, since the occupation in April 1940, extraordinary financing has required official borrowing on an extensive scale, as the table shows.

In addition to the D.Kr. 877 million shown in the table for 1941–42, D.Kr. 250 million was raised for unemployment relief, through a special fund formed in October 1940, increasing the total of official borrowing in the financial year to over D.Kr. 1,100 million. The sum required for unemployment relief was raised by two loans issued simultaneously to the public in September 1941: a $5\frac{1}{2}$-year $2\frac{1}{2}$ per

Danish budgets(1) and official financing.

Year ending 31st March in millions of D.Kr.	1939–40	1940–41	1941–42
Revenue	621	900	918
Expenditure	611	843	905
Surplus	9	57	13
Clearing account	—	498	476 (3)
Payments to occupying authorities etc.(2)	—	514	414 (3)
Total official credit financing	(– 9)	955	877
Financed – from central bank(4)	83	932	737
– in other ways	(– 92)	23	139

(1) Closed budgets 1939–40 and 1940–41; estimates for 1941–42 (including supplementary).
(2) The increase of "sundry debtors" at Danmarks Nationalbank.
(3) Including proportions of the "adjustment account" at the Nationalbank.
(4) The increase of the items "clearing accounts" and "sundry debtors" plus the "adjustment account" and the movement of the government's current account (or overdraft) at the Nationalbank.

cent. issue at par for D.Kr. 180 million and a 25-year 4 per cent. issue at 97¾ for D.Kr. 70 million; subscriptions to the shorter-term loan were made contingent upon a certain subscription to the long-term issue. Small issues of Treasury bills have also been authorised: the authorisation for an extraordinary issue of D.Kr. 130 million lapsed at the end of 1941 but the limit for the ordinary issue was raised from D.Kr. 80 million to D.Kr. 100 million.

Payments to the army of occupation (including the withdrawal of Reichskreditkassenscheine) and advances to Danish creditors on clearing accounts are financed directly by the central bank, as shown below.

Danmarks Nationalbank.

End of month in millions of Danish crowns	Assets								Liabilities		
	Claims on Germany (1)				Credit granted		Gold and foreign assets (5)	Total of balance sheet	Notes	Sight accounts	
	"Sundry debtors"	Clearing account	Adjustment account (2)	Total	to private economy (3)	to government (4)				Private	Government
1939 December	47	—	—	47	583	147	125	952	600	134	—
1940 March	47	—	—	47	560	83	125	865	609	75	—
June	105	123	—	228	403	208	126	1,016	697	165	—
September	294	339	—	633	307	43	126	1,159	695	265	—
December	466	412	—	878	256	—	126	1,309	741	350	—
1941 March	561	498	—	1,060	228	3	133	1,473	707	554	—
June	682	588	—	1,270	237	—	128	1,681	748	700	16
September	777	711	—	1,488	197	—	133	1,863	746	826	82
December	907	849	—	1,756	192	—	125	2,118	842	882	148
1942 March	914	910	125	1,949	96	—	124	2,216	815	1,016	156

(1) Except for a small amount indicated by the pre-April-1940 level of "sundry debtors".

(2) An account to be settled by the Danish Government — the book loss on the Reichsmark holdings due to the appreciation of the Danish crown by 8.3 per cent. in January 1942.

(3) Advances, loans, overdrafts, bills discounted and holdings of bonds and shares.

(4) The overdraft of the Ministry of Finance.

(5) During 1941 the gold holding fell from D.Kr. 115 million to D.Kr. 98 million while correspondents abroad rose from D.Kr. 11 million to D.Kr. 27 million.

A remarkable feature of the Nationalbank's returns (in striking contrast to the central bank's returns in Belgium and Holland) is the comparatively small increase of the note issue in face of the huge expansion of credit against claims on Germany (which have, in fact, now reached a total more than double the note circulation). For the two years of occupation to the end of March 1942, the total amount advanced to the occupying authorities and to creditors in the clearing was about D.Kr. 1,900 million; D.Kr. 240 million has been absorbed by the turning-over of the government's account from an overdraft to a deposit and D.Kr. 460 million by the reduction of credit to the private economy of the country (including open-market sales of bonds by the Nationalbank); but of outstanding importance has been the piling-up of some D.Kr. 940 million on private (mostly bankers') accounts, so that the note circulation has expanded by a little over D.Kr. 200 million, i. e. slightly exceeding 10 per cent. of the claims on Germany.

The commercial banks over the same two years have received a glut of new funds: D.Kr. 540 million on current account, D.Kr. 300 million on time

Danish Commercial Banks.

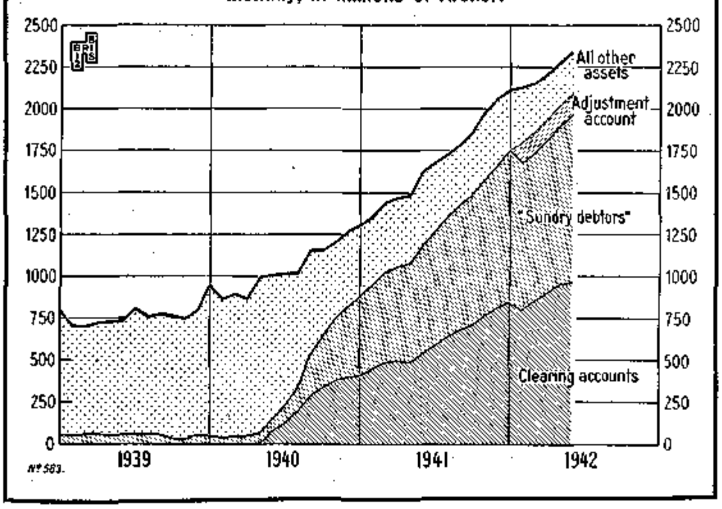
At end of month in millions of D.Kr.	Assets			Total balance sheet	Liabilities		
	Cash	Credit granted (1)	Bonds and shares		Current ac-counts	Time depo-sits	Depo-sits of other banks(2)
1939 December	211	2,275	454	3,564	843	1,612	132
1940 March . .	130	2,250	430	3,348	702	1,647	116
June . . .	233	2,217	458	3,465	790	1,620	161
September	301	2,114	580	3,592	847	1,691	219
December	450	2,070	636	3,759	958	1,657	243
1941 March . .	614	1,929	670	3,785	939	1,747	286
June . . .	753	1,973	698	4,074	1,100	1,768	339
September	844	1,965	720	4,175	1,117	1,858	362
December	952	1,898	861	4,409	1,258	1,857	395
1942 March . .	1,044	1,817	915	4,461	1,246	1,951	436

(1) Advances, overdrafts and bills discounted. (2) Including savings banks.

deposit and D.Kr. 320 million from savings and other banks; but they have been content to hold D.Kr. 900 million of the new money as increased cash reserves (nearly all on non-interest-bearing deposit at the Nationalbank) and to maintain their earning assets almost unchanged (increased investments of D.Kr. 480 million, which include participation in the unemployment relief loan of September 1941, doing little more than replace some D.Kr. 430 million of customers' credit repaid).

The expansion of central-bank credit has produced liquid markets, and some government conversions have taken place, the latest being of the 5 per cent. 1919 loan of D.Kr. 145 million to a 4½ per cent. basis in February 1942. Bank rate has not, however, been lowered but has remained unchanged at 4 per cent. since October 1940. The commercial banks have also kept their credit rates unchanged but have twice reduced their deposit rates, in May 1941 and in January 1942; current rates range from ¼ per cent. on giro accounts to 3–3½ per cent. on 3-month deposits; savings-bank rates have also been reduced, 3-month deposits now getting 3½–4 per cent. It is noteworthy that, compared with the increase of deposits at the commercial banks, savings-bank deposits in 1941 rose by only D.Kr. 215 million.

Danmarks Nationalbank – Distribution of Assets.
Monthly, in millions of Kroner.



Note: Clearing accounts and "sundry debtors" represent claims on Germany. "All other assets" include the gold and foreign exchange items. Domestic credit (of all kinds) outstanding at the end of March 1942 amounted to less than 5 per cent. of the total assets of the bank.

In the spring of 1942, when the possibilities of offsetting the expansion of central-bank credit against claims on Germany by a reduction of the central bank's other assets had become very restricted (as the accompanying graph shows), a comprehensive plan was proposed to absorb the excess of idle money: the measures originally contemplated included the issue of government debt certificates and savings bonds directly to the public (thus excluding the banks) and the tying-up of the commercial banks' cash reserves at the Nationalbank in a proportion amounting to 25 per cent. of their sight and one-month deposits; legislation on these lines, but with some modifications, was introduced in June 1942.

For Norway, no central-bank return has been published since 30th March 1940. "Expenditure in connection with the war" was included at N.Kr. 250 million in the budget for 1940–41 and N.Kr. 545 million for 1941–42: but these sums do not even approximately cover the costs of occupation and the occupying authorities, therefore, draw on their account at the Norges Bank for the amounts which they need. Unofficial estimates place the aggregate payments made to the occupying authorities at N.Kr. 1,500 million up to the end of 1940, and N.Kr. 3,800 million up to the end of 1941. A considerable part of these payments has been financed by an extension of central-bank credit, the note circulation of the Norges Bank, which was N.Kr. 600 million in March 1940, being estimated at N.Kr. 1,000 million and N.Kr. 1,500 million at the end of 1940 and 1941 respectively. From March 1940 to December 1941 the cash reserves of the commercial and savings banks rose by N.Kr. 670 million and, owing to the liquidity of the market, it is probable that the bulk of the central-bank credit to the private economy of the country, some N.Kr. 340 million in March 1940, has been extinguished. The increased cash reserves of the commercial banks is shown in the following table.

Norwegian Banks' Returns.*

At end of year in millions of N.Kr.	Commercial banks							Savings bank deposits
	Assets			Total balance sheet	Liabilities			
	Cash	Securities	Loans		Deposits	Rediscounts	Capital and reserves	
1939	52	183	1,228	1,794	949	22	242	1,542
1940	358	316	1,056	2,164	1,360	1	244	1,423
1941	590	957	826	2,757	1,792	—	252	1,608

* Returns applying to 97 per cent. of the resources of all the commercial banks and about 80 per cent. of those of the savings banks.

Savings-bank deposits decreased to N.Kr. 1,380 million in the autumn of 1940 and have since risen steadily, in 1941 by N.Kr. 185 million; the security holdings of these banks rose in 1941 by N.Kr. 130 million to N.Kr. 730 million. Commercial-bank deposits increased by N.Kr. 430 million during the year and N.Kr. 230 million loans were repaid, while the banks' security holdings rose by N.Kr. 640 million. In 1941 the banks were released from the legal prescription that total commitments should not exceed ten times their capital and reserves.

Three government loans were floated during 1941, all at 3½ per cent.: in March 1941 a 10-year issue for N.Kr. 100 million, in November a 30-year issue, also for N.Kr. 100 million, and in March 1942 a 40-year issue for N.Kr. 200 million. In 1941 a number of conversions of mortgage, industrial and other bonds to a 3½ per cent. basis were made: the N.Kr. 50 million War

Damage Insurance loan issued in June 1940 was converted in October 1941 from 4 to 3 per cent., with a three-year currency. (In December 1941 it was announced that the war damage caused during the two months 9th April to 9th June 1940 had been calculated at N.Kr. 340 million, not including damage to municipal buildings, railways, bridges, etc. and requisitioning effected by the armies, which would raise the total to about N.Kr. 500 million.)

Treasury bill issues have been made in connection with the financing of the occupation. The amount issued has not been published, but was estimated at N.Kr. 500–600 million at the end of 1940. In 1941 issues were of 6-month bills, at 1 per cent., with an option for the government to renew for a further six months; since the beginning of 1942 bills have been issued at 2, 3, 4, 5, 6 and 9 months, at rates ranging from ½ to 1¼ per cent. Bank rate remains at 3 per cent., to which it was reduced in May 1940. The big three Oslo banks abolished from 1st May 1941 the ½ per cent. interest they paid on sight deposits; but decrees of the Minister of Finance ordered the payment of at least ¼ per cent. on sight deposits of under N.Kr. 1 million from 1st December 1941 and at least ½ per cent. from 1st March 1942.

The Balkan campaign in the spring of 1941 led to the occupation of Yugoslavia and Greece. Hostilities between Germany and Yugoslavia began on 6th April 1941 and were suspended about ten days later. At the time of the military occupation, monetary conditions were chaotic. The Yugoslavian note issue, as a result of direct government borrowing from the central bank, had risen from Din. 6.9 milliard at the end of 1938 to Din. 14.3 milliard on 22nd March 1941 (the last return issued); estimates of the circulation in April 1941 vary from Din. 16 to 20 milliard (part of the reserve of printed notes having been put into active circulation). After the partition of the country the old National Bank of Yugoslavia was put into liquidation and two new banks of issue set up in the territories of Serbia and Croatia (see Chapter VI), whose first task was the exchange at par of old Yugoslav notes for the new Serbian dinars and Croatian kunas. Reichskreditkassenscheine, which had been put into circulation from April, were also exchanged; Kassen were set up on 31st July in Belgrade (Serbia) and Agram (Croatia). The commercial banking situation was also one of great confusion. The provisions of the old moratorium of 1934 were still in force and further restrictions on the withdrawal of deposits had been imposed at the outbreak of the war in 1939.

In Serbia notes up to 500 dinars were exchanged directly, while the exchange of 1,000 dinar notes (about one-half of the circulation) was at first restricted, receipts being issued for the larger sums surrendered. On 25th May 1941, a decree of the German military commander placed restrictions on the withdrawal of old bank deposits (in excess of Din. 2,000) existing before 18th April 1941, while new balances were free. On 6th June provision was made for the postponement for one year of maturing debts which the debtor was unable to meet owing to circumstances arising from the war. In November 1941 a plan was drawn up for the reorganisation of the banking system and the establishment of a Bank Control Board and in April

1942 it was announced that at least 55–60 per cent. of all Serbian banks would be required to go into liquidation (permission to continue business being generally refused to banks which still needed the protection of the 1934 moratorium provisions).

At the end of December 1941 the Serbian National Bank reduced its discount rate from 5 to 4 per cent. and the lombard rate from 6 to 5 per cent.; in January 1942 deposit rates for the commercial banks were fixed, ranging from 1 per cent. on sight accounts to 3 per cent. on one-year deposits, while the highest rate for new credits was fixed at 8 per cent., including expenses, instead of the previous level of 10–12 per cent. plus expenses.

A stream of funds is reported to have flowed towards the sounder banks, deposits at the State Mortgage Bank, for example, reaching a higher level for Serbia alone in the spring of 1942 than was previously held for the whole of Yugoslavia. As corresponding investments were not available, the cash holdings of these banks grew considerably. The National Bank at first opened current accounts bearing interest at 1½ per cent. up to Din. 1 million and at 1 per cent. above this amount. Later, from March 1942, the National Bank issued Kassenscheine, at discounts ranging from 2 per cent. for three months to 3 per cent. for twelve months, to mop up the surplus funds on the market; at the same time, the rates paid on current accounts were halved.

At the end of the first year's operations (early June 1942) the Serbian National Bank had a note circulation of Din. 10 milliard, of which Din. 6.8 milliard was due to the exchange of old Yugoslav notes and the remainder had been issued largely on account of occupation costs and clearing claims; interest-bearing current accounts amounted to Din. 1.8 milliard, while nearly Din. 1 milliard Kassenscheine had been issued.

A transitional budget, covering the period from 1st July to 31st December 1941, estimated taxation receipts at Din. 1,340 million and the surplus from government enterprises at Din. 250 million; a further Din. 1,000 million was obtained from Treasury certificates placed with the Serbian National Bank. For 1942, budget estimates reached Din. 5,000 million, of which Din. 2,250 million was from taxation receipts and the balance from the surpluses of monopolies and government enterprises. Provision was made for the resumption of service on the part of the Yugoslav public debt held in Serbia, which had been suspended since April 1941.

In *Croatia* some delay in the exchange of notes occurred owing to printing difficulties. The old Yugoslav notes of Din. 1,000 were exchanged in the middle of June and the Din. 500 notes in the middle of July for similar notes of smaller denominations, receipts being given for the larger amounts brought for exchange. The Din. 100 and 50 notes were called in on a single day at the end of August (to preclude improper exchanges); notes of 10 and 20 dinars were exchanged in the second half of November. The first Croatian kuna notes appeared at the beginning of August, and by 22nd

November 1941 their circulation was given officially as Kunas 7,400 million; at the same time the giro accounts held with the State Bank amounted to Kunas 2,683 million (against a figure of Kunas 1,250 million given for the end of September).

Statistics published for fifteen Croatian commercial banks (comprising about three-quarters of the resources of all the banks) show that in the first months of 1941 the withdrawal of bank deposits was retarded by the restrictions, but in the second half of the year there was a considerable increase of deposits, which, by November, were some 85 per cent. higher than the low level of April.

Croatian commercial banks.

At end of month in millions of kunas	Assets			Liabilities				
				Deposits etc.				Rediscounts
	Cash	Bills (1)	Advances etc.	Current accounts	Savings	Other (2)	Total	
1941 January	635	471	1,799	1,280	1,561	623	3,464	290
March	519	598	1,946	1,140	1,516	828	3,484	418
April	544	688	1,800	1,030	1,459	731	3,220	491
June	2,054	558	2,004	1,907	1,668	1,738	5,313	299
September	2,283	424	2,268	2,304	1,775	1,648	5,727	181
November	2,259	.	2,595	2,316	1,796	1,842	5,954	122

(1) Including rediscounts. (2) "Kreditoren".

This increase of deposits was due to a number of reasons, including the legal obligation put on the economy of the country to place liquid resources with the banks, the deposit of old Yugoslav dinar notes not immediately exchanged for kunas, and the withdrawal of Reichskreditkassenscheine. The cash reserves, less rediscounts, rose from Kunas 53 million in April to Kunas 2,137 million in November. As from 12th November 1941 restrictions on withdrawals, imposed at the outbreak of war and in April 1941, were lifted, while several important banks were able to dispense with the protection given by the old moratorium provisions.

The first Croatian budget estimates, for 1942, give total ordinary income at Kunas 10,900 million, made up of Kunas 10,600 million from taxation and Kunas 300 million from government enterprises; an extraordinary budget is to be covered by loans. A first issue of 2 per cent. 3-month Treasury certificates on 1st December 1941 produced Kunas 2,077 million; this issue was automatically prolonged on 1st March 1942 at 2½ per cent. Later, in March 1942, a further Kunas 923 million were issued, bringing up the total to the authorised amount of Kunas 3,000 million. At the same time the Croatian State Bank, which is under an obligation to lombard these certificates, lowered its discount rate from 5 to 4 per cent. and the lombard rate from 6 to 5½ per cent. In November 1941 the rates for deposits at the banks had been fixed at 1½–4 per cent., while their lending rates remained at around 7–9 per cent.

Very little statistical information has been available from Greece since the occupation of the country by German and Italian forces in April 1941.

The general moratorium which was declared has been prolonged from time to time, while the service of the internal public debt, which had been interrupted for a short period, was resumed from 17th July 1941. At the Bank of Greece a German and an Italian Commissioner have been appointed. The note circulation of the Bank of Greece was Dr. 18.1 milliard on 15th March 1941 (the last return published) compared with Dr. 9.5 milliard at the end of 1939: in addition, Reichskreditkassenscheine and drachma notes of the Mediterranean Bank (under Italian auspices) are also legal tender; in July 1941 the Finance Minister stated that the Bank of Greece held RM 10 million in Reichskreditkassenscheine and that the amount still in circulation was not much higher. Some withdrawals of Greek currency took place in the territories separated from Greece but early in June 1942 the note circulation was reported to have risen to Dr. 85 milliard (compared with Dr. 24 milliard a year earlier). Bank rate was reduced from 6 to 5 per cent. on 21st July 1941 and raised again to 6 per cent. on 1st March 1942.

In 1941 customs receipts, one of the most important sources of revenue, fell off considerably while expenditure rose, first as a consequence of the war and later on account of occupation costs and increased civil outlay. New taxation was introduced in August and in November 1941. How far it has been necessary for the government to borrow from the Bank of Greece to cover current expenditure is not known. A decree published in May 1942 authorises the Minister of Finance to borrow from the commercial and savings banks against 4 per cent. 3-year debt certificates; the banks may refinance these loans and regain their liquidity by issuing short-term nominative certificates at interest from 2½ to 4 per cent. up to the equivalent of the amount lent to the government, the certificates being government-guaranteed; the banks are also authorised to borrow equivalent amounts from the Bank of Greece. Early in June 1942 nearly Dr. 4 milliard had been lent by the banks to the government.

Three countries of south-eastern Europe, Hungary, Bulgaria and Roumania, were subject to very similar influences in 1941. Each of the three countries increased its territory during the year, Hungary attaching part of old Yugoslavia, Bulgaria obtaining part of Yugoslavia and Greece, and Roumania regaining Bessarabia and acquiring the administration of Transnistria; these changes involved the issue of domestic bank-notes by the central banks, in exchange for the notes formerly circulating in the new territories, and supplementary budget expenditure for immediate reconstruction work in districts where, for the time being at least, tax capacity was low. Further, the three countries acted as transit territories and as operational and supply bases for the German army, and themselves became active belligerents. The financing of war expenditure in these three countries thus came on top of the extra outlay on the newly-attached territories and the financing of clearing and similar claims. The changing territorial conditions and the lack of comprehensive Treasury and public-debt statistics make a detailed appreciation of the budget positions difficult, and reliance must be placed largely upon a study of the monetary effects as shown by central-bank and other banking returns.

In Hungary several increases of taxation have recently been made and the ordinary budgetary revenue (excluding the state enterprises) rose from Pengö 937 million in 1939 to Pengö 1,242 million in 1940 and Pengö 1,928 million in 1941 (eleven months only in each case) while estimates for 1942 amount to Pengö 2,060 million. The income and expenditure of the state enterprises roughly balance at around Pengö 1,000 million, while the five-year "investment" plan, which covers defence expenditure, probably took about Pengö 1,000 million in 1941, of which part was covered by special taxes. According to the annual report of the National Bank of Hungary, the greater part of the government's credit requirements on budget account in 1941 was covered by the issue of two long-terms loans: in the first half of the year a $4\frac{1}{2}$ per cent. 10-year Transylvanian loan for Pengö 250 million was issued at 98; and in December a Pengö 100 million 20-year premium loan was issued at par with interest at 4 per cent. plus prizes costing the Treasury a further 2.3 per cent. yearly, making the real yield 6.3 per cent.

The second loan was absorbed by the public but Pengö 120 million of the first loan was taken directly by the commercial banks, which also largely financed a block of Pengö 100 million taken by industrial enterprises. The balance sheets of ten leading Budapest banks reflect these transactions.

Hungarian Commercial Banks.

At end of year in millions of pengö	Assets					Total of balance sheet	Liabilities		
	Cash	Credit to private economy		Government paper			Deposits etc.		Rediscounts etc.
		discounts* and advances	securities	short-term	long-term		current accounts	savings deposits	
1940	143	1,211	288	492	100	2,748	848	581	550
1941	152	1,821	364	426	200	3,343	1,045	581	996

* Including bills rediscounted.

These ten banks took up Pengö 98 million of the government long-term loan (out of the Pengö 120 million taken by all the banks) but had Pengö 64 million short-term paper redeemed, so that their net direct lending to the government was only Pengö 34 million. The increase of credits to the private economy of the country, on the other hand, amounted to Pengö 675 million, including Pengö 610 million in the form of discounts and advances; a considerable proportion of this sum was lent indirectly to the government, part going to the Futura (an official organisation which purchases agricultural products), part to finance the war industries and part to enable industrial enterprises to take up their share of the long-term Transylvanian loan. The banks thus expanded their credit items by rather over Pengö 700 million in all.

Savings deposits showed stagnation, however, while current accounts rose by less than Pengö 200 million, so that extra resources had to be obtained in other ways; thus, rediscounts, largely made directly or indirectly at the National Bank, rose by Pengö 446 million on the year to almost Pengö 1,000 million, representing over one-half of the banks' total bill portfolio.

As the smaller banks largely borrow from their Budapest correspondents, the rediscounts of the Budapest banks are reflected very clearly in the increase of the National Bank's bill portfolio, which rose by Pengö 486 million in 1941.

National Bank of Hungary.

At end of month in millions of pengö	Assets				Total* of balance sheet	Liabilities		
	Claims on Germany	Bill portfolio	Advances to Treasury			Note circulation	Current accounts	
			direct	on account of notes exchanged			public	private
1939 December	—	585	217	95	1,486	975	100	86
1940 December	—	710	315	255	1,843	1,387	84	77
1941 March	—	729	314	296	1,858	1,369	127	50
June	—	825	313	490	2,267	1,756	159	50
September	108	1,017	312	490	2,477	1,909	269	68
December	140	1,196	301	490	2,795	1,984	372	100
1942 March	267	1,117	260	500	2,734	1,999	316	64

* Amongst the items omitted from the table is the gold and foreign exchange holding, which fell from Pengö 159 million to Pengö 118 million during the year 1941, a change due principally to writing down the value when the currency was appreciated in September.

The expansion of the credit items other than the bill portfolio of the National Bank was predominantly on official account. The debt of the Treasury on account of notes issued in exchange for foreign bank-notes withdrawn in the newly-attached territories rose in 1941 from Pengö 255 million to Pengö 490 million; at the end of the year this amount included Pengö 83 million representing Czecho-Slovak currency withdrawn, Pengö 215 million Roumanian lei and Pengö 191 million Yugoslav dinars. The increase of Pengö 235 million on this account was, however, more than offset by the repayment of Pengö 14 million direct advances to the Treasury and the accumulation of a further Pengö 288 million on public current accounts at the National Bank.

A new item in the return, which first appeared at the end of August 1941, was the "Pengö advances made to foreign countries under Article 57 of the Statutes": these advances, made to finance the surplus of Hungarian exports to Germany on clearing account, reached Pengö 140 million in the middle of October and remained unchanged from that time until the end of the year; a further increase from the middle of January carried the total up to Pengö 267 million at the end of March and Pengö 343 million at the end of May 1942.

Interest rates did not greatly change during the year, bank rate remained at 3 per cent. and the market rate for first-class bills at 4–5½ per cent. Owing to the considerable demand for credit and the sluggishness of deposits, the commercial banks have shown some reserve in the granting of credit. The government requested the banks to reduce their rates for credits to small traders and artisans from 6½ to 5½ per cent. and to refrain from adding commission. Further, the National Bank drew up some guiding principles for the banks to observe in granting credit, with the object of ensuring cover for credit requirements due to the war economy and other vital purposes and to prevent speculation.

The note circulation in Bulgaria more than doubled in 1941, as may be seen from the following table.

National Bank of Bulgaria.

At end of month in millions of leva	Assets						Total of balance sheet	Liabilities				
	Gold and foreign exchange	Clearing assets *	Investments	Govt debt etc.	Advances and bills	"Other assets"		Note circulation	Current accounts and deposits			"Other liabilities"
									government	bank	others	
1939 Dec. . .	2,010	1,782	866	3,793	1,470	138	10,530	4,245	1,479	1,328	1,028	451
1940 Dec. . .	2,010	2,336	1,824	3,953	2,243	488	13,220	6,518	1,934	1,059	791	911
1941 March .	2,046	3,770	2,034	3,793	1,346	790	13,748	7,800	860	940	1,231	1,185
June . .	2,046	7,465	2,486	3,322	389	651	17,266	8,861	1,762	1,202	2,248	1,458
Sept. . .	2,265	8,674	3,949	4,422	753	1,015	21,771	12,330	3,187	1,157	1,778	1,590
Dec. . .	2,774	10,447	4,731	3,933	1,693	741	25,075	13,467	5,727	944	1,448	1,389
1942 March .	2,774	11,509	5,460	3,533	562	2,440	27,010	12,823	5,454	2,250	2,053	2,681
May . . .	2,774	14,491	5,915	3,533	483	4,093	31,921	13,976	5,665	3,193	2,763	4,574

* These are gross assets: there is also an item on the liabilities side of the balance sheet which, in fact, is very small (varying around Leva 50 million).

In round figures, the clearing assets rose by Leva 8,100 million and investments by Leva 2,900 million during the year, the main counterpart being increases of Leva 6,950 million in the note issue and Leva 3,800 million in the government's balance. The clearing assets probably include about Leva 1,000 million of foreign bank-notes withdrawn in the newly-attached territories but consist chiefly of Reichsmark claims. In March 1940 the National Bank was authorised to utilise part of its Reichsmark holding to repurchase Bulgarian Treasury bills (denominated in Reichsmarks) given in payment to German firms largely for armament deliveries; Treasury bills so repurchased appear under "investments". Later it was arranged for the National Bank to take these bills directly from the government. The original authorisation to purchase Treasury bills denominated in Reichsmarks was for Leva 2,400 million and further authorisations increased the total to Leva 12,650 million in the spring of 1942, the amount of the orders placed on government account; the actual amount purchased by the National Bank was about Leva 4,500 million.

In 1941 there was a considerable increase of bank deposits, which reached a record high level; deposits with the Agricultural Bank, the Postal Savings Bank, the popular banks and the big commercial banks rose from Leva 15.4 milliard in December 1939 to Leva 16.8 milliard in December 1940 and Leva 20.8 milliard in December 1941. Bank rate has remained at 5 per cent., to which it was reduced in December 1940.

In 1942 the clearing claims of the National Bank have continued to grow, so that they now exceed the total note issue. The note issue and the government's balance, which expanded so considerably in 1941, ceased to rise, while the accounts of bankers and others increased by Leva 3,600 million in the first five months of 1942. In February 1942, Treasury notes (see Chapter VI) were issued for the first time, and in March the bank was authorised to purchase Bulgarian government securities within limits set only by the direction of the bank. *Of particular interest is the exceptional and considerable increase,* of over Leva 3,000 million each, registered during the first five months of 1942 by the two National Bank items called "other assets" and "other liabilities", which are usually of minor importance.

During 1941 a 5 per cent. 15-year government loan was placed on a compulsory basis, subscriptions being fixed according to the following scale: 3 per cent. of the business capital of private firms and merchants in excess of Leva 500,000; 15 per cent. of net assets of insurance companies and various societies; 15 per cent. of open reserves of share companies, limited liability companies and cooperatives, plus 20–25 per cent. of the increase in value of their assets in the last few years. This loan produced about Leva 3,500 million in 1941 and subscriptions were continued in 1942. Other extraordinary resources were obtained by a capital levy on Jewish property (20 per cent. up to Leva 3 million and 25 per cent. above that figure), estimated to produce Leva 1,800 million (of which Leva 345 million was received in 1941).

Some indication of the growth of the budget in Roumania is given in the table below (which omits the budgets of the state enterprises). The Lei 75 milliard for 1941 does not, however, include the financing of the whole cost of the war. For this purpose the National Bank undertook, by a convention of 19th June 1941, to make advances available to the government up to Lei 12 milliard to meet the "exceptional needs" of the Treasury. These advances were not entered separately in the bank's accounts but booked under the item "sundry accounts", which rose by over Lei 10 milliard in the second half of the year, as is shown in the table on the next page (limited to some of the principal items of the return).

Roumanian budget totals(1).

Calendar years in milliards of lei	Ordinary	Defence (2)	Total
1938	30.3	3.6	33.9
1939	32.9	6.9	39.8
1940	39.5	15.0	54.6
1941	56.8	17.9	74.7

(1) As given in the National Bank's bulletin.
(2) Including Aviation and Navy Fund.

Taking the year 1941 as a whole, there has been a 50 per cent. increase of the balance sheet — spread over almost all the items: the total increase of "sundry accounts" was Lei 16.1 milliard*; the new net advances made against clearing assets amounted to Lei 17.7 milliard; the bill portfolio (consisting largely of Treasury bills discounted by armament firms to which they were given in payment) rose by Lei 7.3 milliard and the security holding by Lei 2.2 milliard. As regards the latter item, the National Bank was authorised in March 1941 to acquire shares in connection with the nationalisation (or "roumanisation")

* It is estimated (Bank-Archiv, 1st February 1942) that from September 1940 to November 1941 the government borrowed in all some Lei 25–30 milliard directly from the National Bank.

National Bank of Roumania.

Near end of month in milliards of lei	Assets					Total of balance sheet	Liabilities			
	Gold (1)	Clearing accounts (2)	Bills discounted	Securities (3)	"Sundry accounts"		Note circulation	Deposits etc. public (4)	Deposits etc. private	Other sight liabilities
1939 December	20.8	0.8	18.9	2.2	8.5	74.3	48.8	1.5	7.5	1.3
1940 December	32.2	0.6	20.5	2.4	5.4	91.5	64.3	3.0	8.6	3.4
1941 March	32.3	1.2	24.7	4.4	6.3	96.7	68.9	3.0	11.8	3.7
June	33.0	9.1	24.2	4.4	10.8	111.8	77.1	3.9	13.8	4.5
September	33.7	16.5	24.9	4.6	19.8	130.2	89.7	6.3	15.4	6.6
December	34.2	18.3	27.8	4.6	21.5	137.8	97.2	3.5	17.4	7.1
1942 March	37.7	11.8(5)	29.2	4.7	27.9	140.7	96.0	5.5	18.3	9.7

(1) Gold was revalued in May 1940, giving a book profit of about Lei 10½ milliard, which was taken by the government.
(2) "Devises en comptes de clearing, décomptées."
(3) Including participations in banks (Lei 3.0 milliard end 1941).
(4) Ministry of Finance, public services and Caisse Autonome.
(5) A reduction in the clearing accounts from Lei 16.9 milliard on 24th January to Lei 10.4 milliard on 28th February 1942 took place in two steps which corresponded to increases of Lei 3.0 milliard in the gold holding and over Lei 3 milliard in the government's advance from the bank. Clearing assets appear, therefore, partly to have been utilised for the purchase of gold and partly transferred to the government for repayment of debts or for other purposes.

of Roumanian industry. As a counterpart to the increase of the National Bank's credit in 1941 the note issue has risen by Lei 32.9 milliard, some 50 per cent. on the year, and deposits etc. by Lei 13.0 milliard.

The total expansion on government account is not, however, fully revealed by a casual examination of the return. In 1940 the revaluation of the gold holding gave the government a book profit of about Lei 10½ milliard; further, notes withdrawn in the ceded territories, which may be estimated at Lei 6 milliard, have been excluded from the note circulation, as shown in the return. Moreover, certain note issues authorised for government account in 1941 are not included in the published figures of the circulation: these comprise some Lei 300 million issued in exchange for rouble notes in Bessarabia and over Lei 3 milliard small notes issued to replace and supplement the circulation of coin.

Bank deposits fell to their lowest point in September 1940, partly on account of the territories ceded and partly owing to withdrawals, estimated at Lei 1–1½ milliard. In 1941 there was a notable increase which carried the total up to a record figure. Relatively, however, bank deposits in Roumania are very small, amounting (even with the inclusion of savings-bank deposits) to only one-third of the note issue.

Roumanian bank deposits.

At end of month in millions of lei	Commercial banks*	National Savings Bank: Savings accounts	National Savings Bank: Postal cheque accounts	Total
1939 December	15,340	3,250	2,060	20,650
1940 September	12,829	2,905	1,516	17,250
December	15,605	3,292	2,095	20,992
1941 December	22,581	5,439	4,657	32,677

* Large commercial banks: savings and other deposits plus creditor accounts.

In August 1941, a Unification loan was announced for the reconstruction of Bessarabia and Bukovina; this, it was hoped, would absorb part of the notes hoarded (estimated by the Finance Minister at Lei 40 milliard, nearly one-half of the total circulation). The loan was issued in two tranches: 4½ per cent. bonds issued at 90 and repayable in 30 years at 120, with prizes amounting to a further 1 per cent. per annum; and a special tranche for peasants at 5 per cent. for 5 years, with prizes of cattle and agricultural implements. Subscriptions to the loan were made obligatory: property owners and industrialists had to subscribe the equivalent of one year's taxation, and salaried classes one month's salary, while the peasants were assessed on the area of their land, e. g. with 3 to 5 hectares, Lei 1,000 was payable; from 40–1,000 hectares, Lei 400 per hectare, etc. The loan produced Lei 12 milliard, which the Finance Minister considered unsatisfactory. During 1941 about Lei 14 milliard of pre-1920 public debt was simplified and unified into new 4 per cent. 40-year bonds.

Bank rate has remained at 3 per cent. (2½ per cent. for agricultural bills), to which it was reduced in September 1940. Long-term rates are indicated by the quotations on the Bucarest stock exchange of the 5 per cent. government loans of 1919–22, which fluctuated at around 50 per cent. of their par value.

The most important monetary influence in Slovakia has been the financing of the clearing surplus, the debt of Germany (and the Protectorate) having risen from Ks. 1,000 million to Ks. 2,000 million during 1941.

Slovak National Bank.

At end of month In millions of Slovak crowns	Assets				Total of balance sheet	Liabilities		
	"Other assets"*	Discounts and advances	State note debt	Gold and foreign exchange		Note circulation	Deposits etc.	"Sundry liabilities"
1939 December	898	336	469	57	1,787	1,392	208	87
1940 December	1,022	516	469	108	2,147	1,657	207	181
1941 December	1,441	451	469	97	2,639	2,023	147	364
1942 March	1,540	256	469	82	2,590	1,957	154	370

* End-of-year balance sheets show that the clearing accounts included under this item amounted to Ks. 398 million and Ks. 845 million for December 1940 and December 1941 respectively.

Part of the increase of clearing assets is reflected by the rise in the item "other assets" in the National Bank's return, this item now amounting to more than three-quarters of the note issue. But from December 1940 to March 1942 the increase of "other assets" by over Ks. 500 million has its counterpart as to only Ks. 300 million in the note issue, the balance being booked under "sundry liabilities", representing no doubt the Kassenscheine issued to cover the payment of old claims in the clearing. Other influences on the central bank were small, the decline in discounts and advances being balanced by the fall in deposits, while the budget was covered without direct recourse to the National Bank.

By the end of 1941 the banking concentration, undertaken when Slovakia became a separate country in 1939, was practically completed; the number of banks had been reduced from 32 to 15 (particulary by the elimination of Protectorate interests). Savings deposits at the commercial and savings banks have not greatly varied from Ks. 3,000 million but current accounts rose from Ks. 2,300 million in December 1939 to Ks. 2,850 million in December 1940 and about Ks. 3,500 million in December 1941 (a movement which has continued in 1942).

Bank rate remains at 3 per cent. (since March 1939); in 1941 the banks paid 2¼ per cent. on current-account and 3½ per cent. on savings deposits, while credits cost 7½ per cent. plus turnover tax. The 3½ per cent. two-year Kassenscheine are issued at 97, giving a yield of 4.8 per cent., but have fallen at times to 90, and below, on the market. To support the market a rediscount institute, under the auspices of the Slovak Mortgage and Communal Bank, has been formed with resources which will amount to Ks. 300 million, obtained partly from the government and partly from obligatory deposits from the banks, insurance companies etc., and steps have also been taken to keep part of the Kassenscheine off the market. Indeed, as a result of the laws providing for forced investments in government securities, it is estimated that over 70 per cent. of the debt is "firmly held".

At the end of 1941 the government debt totalled Ks. 3,150 million, including a conversion issue of Ks. 1,400 million to cover part of the Czecho-Slovak public debt allocated to Slovakia (out of the total of Ks. 1,800 million thus allocated, Ks. 300 million was settled through the clearing and Ks. 100 million by a cash payment). In the spring of 1942 special measures were taken to ensure the placing of a new government loan of 4½ per cent. 20-year bonds for Ks. 500 million: the banks' interest rate on private current accounts was reduced from 2¼ to 1½ per cent. (the savings-deposit rate remaining unchanged), while the proportions of their resources which savings banks, insurance companies and social funds respectively are obliged to invest in government bonds were raised and provision was made for share companies, cooperatives etc. to build up blocked reserves in government securities.

In the north of Europe, Finland also served as a base for German troops in 1941 and itself became a belligerent. But, unlike the countries of south-eastern Europe, Finland accumulated an appreciable debt in the clearings, partly as a result of the war with the U. S. S. R. (30th November 1939 to 13th March 1940), from which Finland was slowly recovering in the year of peace up to the middle of 1941.

Before 1939 Finland's ordinary expenditure of around FM 3,500 million was more than covered by ordinary revenue and the total internal debt was very small, being under FM 3,000 million. Expenditure rose sharply during the "winter war" of 1939–40 and, after the signing of the peace treaty, plans were set on foot to pay reparation for damage caused by the war and indemnities to owners of property in the territory ceded to the U. S. S. R.; with the reopening of hostilities on 25th June 1941, these plans were suspended and outlay on the war again soared. Total budgetary expenditure in 1941 amounted to FM 20 milliard, of which FM 14 milliard was for national defence. To meet this expenditure, severe increases were made in taxation, and estimates of revenue from taxation in 1942 at FM 8,800 million are more than double receipts in 1940. But the cost of the two wars is more closely reflected in the rapid swelling of the internal debt to nearly FM 26 milliard at the end of March 1942. From slightly over FM 1,000 million in the seven months to June 1940, the monthly increase in the debt fell to FM 350 million during the "peace year", but rose again to nearly FM 1,500 million monthly in the last half of 1941. Of the FM 23 milliard increase from June 1939, over FM 16 milliard was floating and under FM 7 milliard consolidated. Nearly FM 5 milliard of the consolidation was made during 1941: three loans were floated during the year, FM 1,000 million in February–March, FM 1,000 million in May–August and FM 2,000 million in September–November, all at seven years and with average yields ranging from about 4½ to 5½ per cent.; further, two lottery loans produced FM 300 million. An issue of FM 1,000 million 2-year 4 per cent. tax certificates to bearer was made from July onwards.

Finland — internal public debt.*

At end of month in millions of FM	Consolidated	Floating	Total
1939 June	2,796	75	2,871
1940 June	3,716	6,935	10,651
December	3,884	9,674	13,558
1941 June	5,319	9,590	14,909
December	8,744	14,444	23,188
1942 March	9,631	16,338	25,969

* In addition, the foreign debt rose from FM 1,190 million in June 1939 to FM 4,129 million in March 1942 (at which date FM 3,358 million was consolidated and FM 771 million floating). The total public debt was thus FM 29.3 milliard at the end of March 1942. Including loans for indemnification payments to Carelians, the public debt is expected to reach FM 50 milliard at the end of 1942.

The value of the government's assets is estimated at FM 40–50 milliard, but the existence of these assets does not, of course, offset the monetary effects of the rapid increase of the internal public debt.

According to the annual report of the Bank of Finland government borrowing from the bank attained FM 10,660 million at the end of 1941 as compared with less than half this amount at the end of 1940. (In the second quarter of 1942 the cost of the war had risen to FM 1,800 million a month.)

Bank of Finland Returns.

At end of month in millions of FM	Assets			Total of balance sheet	Liabilities		
	"Sundry accounts"	Internal bills discounted	Gold and foreign exchange		Note circulation	Private current accounts	Clearing accounts and other foreign debts
1938 December	78	1,042	3,402	5,325	2,086	850	79
1939 December	228	2,358*	2,905	6,809	4,039	686	94
1940 December	1,540	5,275	1,781	9,492	5,551	834	633
1941 March	1,441	5,312	1,671	9,333	5,724	512	623
June	2,191	6,083	1,422	10,686	6,067	813	1,107
September	2,529	7,973	1,202	12,600	6,561	985	2,052
December	—	12,225	1,104	14,178	7,317	1,258	2,536
1942 March	.	.	.	.	7,751	.	.

* Including FM 315 million rediscounted bills.

The government borrowed directly from the central bank (booked under "sundry accounts") to finance the winter war of 1939–40 and also against Treasury bills (under "internal bills discounted"): in 1941 the direct credit was replaced by Treasury bills and the total government debt brought under the same heading. The worsening of the foreign position over the two years is shown by the fall of FM 1,800 million in the reserves of gold and foreign exchange and the rise of over FM 2,400 million in the debt on clearing and other accounts. The annual increase of the note circulation slowed down from FM 2,000 million in 1939 to FM 1,500 million in 1940 but rose to nearly FM 1,800 million in 1941. The rise of private current accounts reflects the increasing liquidity of the commercial banks.

Finnish Commercial Banks.

At end of month in millions of FM	Assets				Total of balance sheet	Liabilities	
	Cash	Internal bills	Loans and overdrafts	Bonds		Current accounts	Deposits
1938 December	1,234	1,770	7,174	1,418	13,246	1,944	7,549
1939 December	809	1,904	7,732	1,255	13,178	2,459	6,940
1940 December	1,854	3,826	7,194	1,655	16,076	4,680	7,470
1941 March	1,032	4,021	7,571	1,756	15,862	4,404	7,672
June	1,471	2,498	8,241	1,656	15,345	4,559	7,254
September	1,511	3,568	8,007	1,970	16,599	5,273	7,285
December	2,056	2,528	8,124	3,612	18,113	6,030	7,408
1942 March	1,581	3,420	7,956	4,334	18,995	6,351	7,920

All the items of the commercial banks show some increase, including credits to the private economy of the country (loans and overdrafts). But of outstanding importance was the expansion of their bond portfolio (reflecting purchases of government market issues and tax certificates) and, on the liabilities side, of current accounts (while longer-term "deposits" show no considerable movement). The general moratorium has been prolonged until the end of 1942.

Interest rates have varied very little, the discount rate of the Bank of Finland remaining at 4 per cent., unchanged since 1934. A new issue of FM 500 million 2-year tax certificates made from January 1942 bore interest, however, at 3 per cent., 1 per cent. below the previous issue.

Compared with the belligerents, the situation of the three continental neutrals, Sweden, Switzerland and Portugal, presents a striking contrast. In these three countries the note issue is covered 100 per cent. and more by gold and foreign exchange. Switzerland and Sweden are bearing considerable defence expenditure, but in these countries the increase of the note issue on the year was small (3 and 15 per cent. respectively), whereas in Portugal it was large (over 50 per cent.). In each case the markets are very liquid and interest rates continue to decline.

Swedish budgetary expenditure is currently at the rate of about S.Kr. 4,000 million a year, of which over one-half is for defence; ordinary revenue rather exceeds S.Kr. 2,000 million, so that the budget deficit and the resultant borrowing run at some S.Kr. 150 million a month. The total public debt has more than doubled from S.Kr. 2,660 million at the end of 1939 to S.Kr. 6,150 million at the end of 1941, when S.Kr. 1,610 million was floating and S.Kr. 4,540 million consolidated. Since the beginning of the war three large defence loans have been issued: the first, in 1940 (4 per cent. 5-year bonds), produced S.Kr. 800 million; the second, at the beginning of 1941 (4 per cent. 10-year bonds and 3 per cent. 10-year premium bonds) brought in S.Kr. 600 million; the third issue, early in 1942, which was in three series (3 per cent. 5-year bonds, 3½ per cent. 40-year bonds and 3½ per cent. savings bonds), had brought in S.Kr. 1,100 million by May 1942. The floating debt consists chiefly of Treasury bills.

The market is very liquid, owing principally to the growth of the Riksbank's reserves of gold and foreign exchange, in 1941, from S.Kr. 1,500 million to S.Kr. 1,800 million (partly as a result of sales by the commercial banks); further, the Riksbank's advances in foreign exchange to the Reserve Stock Office for the purchase of supplies abroad, against government securities, increased from S.Kr. 460 million to S.Kr. 620 million, so that the total expansion due to purchases of gold and foreign exchange was S.Kr. 460 million. As a counterpart there has been some decrease of private credit granted by the Riksbank, an increase of the note circulation and an expansion of the commercial banks' cash reserves to extraordinarily high levels.

In 1941 deposits with the commercial banks increased by S.Kr. 560 million (to S.Kr. 4,880 million), while private credit granted declined by S.Kr. 170 million (to S.Kr. 4,290 million) and their portfolio of government securities, including Treasury bills, expanded by S.Kr. 680 million (to S.Kr. 1,030 million). Savings-bank deposits, which had fallen in 1939 and 1940, rose by nearly S.Kr. 100 million in 1941; at the end of the year a new central institution for the savings banks was formed to administer their surplus funds, which hitherto had mostly been invested at the commercial banks.

Long-term rates have fallen, as is indicated by the better conditions obtained by the Treasury for the defence loans. On the money market, bank rate was reduced from 3½ to 3 per cent. on 29th May 1941; on 1st July the savings banks lowered their rate for deposits from 3½ to 3 per cent., while the commercial banks reduced their time-deposit rate from 3 to 2½ per cent. and in December placed upper limits on the amount of such deposits, at the same time prolonging the period of notice required for withdrawal. The discount on Treasury bills placed with the banks, which early in 1941 had been 2½ per cent., was down to 1 per cent. by the end of the year.

The Swiss ordinary budget for 1941, with expenditure at around Sw.fcs 460 million, showed a deficit of Sw.fcs 40 million. In addition, defence expenditure totalled Sw.fcs 1,300 million, of which Sw.fcs 470 million was met by extraordinary revenue, particularly from the prodeeds of a capital levy called the "sacrifice for defence", so that the extraordinary budget deficit was about Sw.fcs 830 million. The total deficit of Sw.fcs 870 million was covered principally by four loans: in May 1941 two loans, at 3½ per cent. for 12 years and 3 per cent. for 6 years, each produced Sw.fcs 280 million; in November, the terms for the government were improved, a 3¼ per cent. 15-year loan produced Sw.fcs 320 million and 2½ per cent. 5-year certificates Sw.fcs 270 million; of the Sw.fcs 1,150 million produced by these loans, Sw.fcs 320 million was utilised for conversion of old loans, making Sw.fcs 830 million new money received. In addition, some Sw.fcs 140 million Treasury bills were placed on the market, particularly with the banks. The estimates for 1942 include Sw.fcs 1,300 million extraordinary expenditure and foresee a deficit of over Sw.fcs 1,000 million. A vast plan of work-creation, drawn up in case a shortage of raw materials leads to unemployment on a large scale, includes the expenditure of a sum approaching Sw.fcs 5,000 million over a ten-year period.

That the budget deficit in 1941 has been covered practically without credit expansion is shown by the returns of the banks. The most important movement in the assets of the National Bank in 1941 was the increase in the reserve of gold and U.S. dollars by Sw.fcs 380 million; other assets fell, private credit (discounts and advances) by Sw.fcs 50 million, Treasury bills placed with the bank by Sw.fcs 145 million and other government securities by Sw.fcs 20 million; by the end of 1941 the total of all these credit items outstanding was less than Sw.fcs 150 million. In these circumstances the note issue rose by only Sw.fcs 60 million to Sw.fcs 2,340 million (by less than 3 per cent.), while the government's balances increased by Sw.fcs 188 million to Sw.fcs 195 million. Similarly, the aggregate balance sheet of the seven big banks rose by only Sw.fcs 100 million to Sw.fcs 4,500 million, the purchase of Treasury bills (Sw.fcs 100 million) and other government securities (Sw.fcs 270 million) being offset by the reduction of other assets (particularly of the cash reserve by Sw.fcs 240 million).

Interest rates remain very low: bank rate has been at 1½ per cent. since 1936 and the private discount rate is 1¼ per cent.; the rates paid on Kassenscheine by the cantonal banks were reduced from 3.56 per cent. to 3.03 per cent. during 1941, first mortgage rates declined from 3.95 to 3.87 per cent. and the average yield on bonds of the Confederation and the railways (to the nearest maturity date) from 3.75 to 3.04 per cent. The year was notable for the record volume of bond issues both for conversion and for new money, the bulk of the issues in each case being for the account of the Confederation and local bodies.

During 1941 highly-priced exports from Portugal, the difficulties of import by sea and an influx of foreign capital had the effect of more than doubling the Bank of Portugal's gold and foreign exchange holding, the movement accelerating as the year progressed.

The rise of over Esc. 3,400 million in the gold and foreign exchange holding in 1941 went almost equally to increase the note circulation and the cash reserves of the banks; the note issue rose by 50 per cent. and the banks' cash balances at the Bank of Portugal jumped to almost three times their former level.

Bank of Portugal.

Near end of month in millions of escudos	Assets						Total* of balance sheet	Liabilities		
	Gold and foreign exchange				Bills and advances	Securities		Note circulation	Deposits etc.	
	gold	gold abroad etc.	other foreign exchange	total					Treasury	banks
1939 December	920	869	230	2,019	452	116	5,295	2,550	161	603
1940 December	1,239	869	785	2,893	442	330	6,055	2,903	247	851
1941 March	1,270	1,154	997	3,421	362	329	6,206	2,779	394	1,310
June	1,274	1,466	1,273	4,013	358	329	6,681	3,188	359	1,507
September	1,309	1,547	1,919	4,775	351	329	7,438	3,501	428	1,926
December	1,343	1,798	3,193	6,334	337	355	9,022	4,488	325	2,433
1942 March	1,363	1,927	4,338	7,628	302	355	10,220	4,388	1,193	2,915

* The chief item omitted on the assets side is the debt of the government, which fell from Esc. 1,036 million to Esc. 1,031 million over the period covered by the table.

Bank rate was reduced in February and March 1941 by two steps of ¼ per cent. from 4½ to 4 per cent. To mop up the excessive liquidity of the market the government issued a 3½ per cent. loan for Esc. 500 million in December 1941.

In Spain further progress has been made under the deblocking law of 7th December 1939 towards clearing up the difficult monetary and banking situation resulting from the over-issue of notes during the civil war of 1936–39. On 10th October 1941 blocked accounts were released to their owners up to the amount of their debts with the banks (estimated at Pesetas 700 million). From 15th November small savings were released up to Pesetas 1,000. And early in December 1941 a decree provided that all blocked accounts at the banks, in so far as their release had been approved in principle by the deblocking law, might be paid off as to Pesetas 525 in cash and the balance in government securities from the banks' own portfolios (at the official quotation for the day). The accounts of non-bankers at the Bank of Spain were paid off in the same way but only 50 per cent. of the bankers' balances were repaid in securities. It was estimated that Pesetas 1,300 million of government securities would change hands as a result of this decree. (A further decree of 27th March 1942 creates new 4 per cent. government 50-year bonds, which may also be utilised to repay bank deposits; the Bank of Spain received Pesetas 600 million for this purpose and further allocations are to be made upon the request of the bank.)

A decree of 13th March 1942 clears the balance sheet of the Bank of Spain, which had acted as reservoir for "red" accounts, from previous abnormal items and regulates for the future the relations of the government and the bank. Various book-keeping measures are prescribed, ending in the establishment of an account entitled "Liquidation results 1936–41", into which directly or indirectly the operating surpluses for these years, profits from the cancellation of "red" bank-notes, any surplus assets from the thawing of "red" accounts, the profits resulting from the liquidation of the former foreign exchange office and the revaluation of the remaining gold holding (at the Treasury's official price) etc. are booked. As the gold holding (accumulated largely in 1914–18 owing to the favourable position of the country at that time) was depleted during the years 1936–39, the National government, which accepts no obligation for the debts of the former Republican and Separatist governments vis-à-vis the Bank of Spain, will create a special form of indebtedness (without interest or maturity) placed at the disposal of the Bank of Spain to restore equilibrium between the assets and liabilities of the bank and to give a guarantee to the note issue. Thus the process of rectifying the position, which has taken three years to put through, comes virtually to an end.

The prohibition to establish balance sheets and hold general meetings was lifted by the law of 17th October 1941 and most of the bank balance sheets for 1936–39 and for 1940–41 have now been issued; the following table gives approximate figures for the main items of the five big banks.

Spanish commercial banks.[1]

In millions of pesetas	Assets				Liabilities
	Loans	Bills	Government securities	Industrial securities	Private deposits
1935	740	970	2,030	650	4,130 [2]
1941	2,740	1,070	4,800	960	8,750

[1] Banco Hispano Americano, Banco Español de Crédito, Banco de Vizcaya, Banco de Bilbao and Banco Central.
[2] 1936.

All asset items have risen, particularly government securities, and deposits have more than doubled. Most of the banks have also increased their capital. The Private Banks' Commission and the Banking Council have been replaced by the Directorate General for Banking attached to the Ministry of Finance.

No returns are yet available for the Bank of Spain, but estimates made by semi-official and expert circles put the total circulation of notes and coin plus the current accounts at the Bank of Spain (some Pesetas 6 milliard in July 1936) at about Pesetas 17 milliard: this figure comprises the circulation of the National government at the end of the civil war, the residue of the "red" circulation (which the National government brought down after the war from Pesetas 22 milliard to Pesetas 7 milliard) and the balance of deblocked "red" bank accounts (revalued on a sliding scale whereby, of an original amount of Pesetas 10 milliard, nearly Pesetas 3 milliard were gradually released).

The market is extremely liquid and the National government had issued Pesetas 6,750 million loans from the end of the civil war up to the end of 1941, the last issue of 4 per cent. perpetual debt, for Pesetas 2,000 million at 90, being made in July 1941: including this issue, the total public debt amounted to Pesetas 28,750 million. Bank rate remains at 4 per cent., to which it was reduced in October 1939.

In Turkey, the outlay on defence, which accounts for about half of the total government expenditure, has led to considerable deficits to be covered by borrowing. The extent of recourse to the Central Bank is shown by the following table.

Central Bank of Turkey.

Near end of month in million of £T	Assets				Total of balance sheet (3)	Liabilities		
	Gold (1)	Clearing and other foreign exchange	Advances to government (2)	Commercial bills and advances		Note circulation	Deposits	Clearings and foreign exchange debt
1939 December	53	11	—	225	511	297	30	47
1940 December	127	33	110	269	751	418	81	35
1941 March	121	49	122	279	776	461	70	27
June	143	45	168	279	840	522	75	29
September	127	46	168	281	825	498	71	27
December	125	61	168	307	868	522	78	23
1942 March	134	73	168	347	926	567	88	29

(1) Including gold abroad.
(2) Secured by a deposit of gold amounting to £T 78 million (shown on the liabilities side of the return).
(3) Other assets include the holdings of Treasury bills and securities, which have declined from £T 141 million to £T 137 million and from £T 58 million to £T 56 million respectively over the period covered in the table.

The note circulation increased in 1941 by £T 104 million, some 25 per cent. Clearing assets and other foreign exchange rose by £T 28 million, particularly in the first and last quarters of the year; commercial bills and advances increased by £T 38 million; the advances to the government, which had risen by £T 58 million to £T 168 million in the first half of the year, remained unchanged until early in April 1942, then rising steeply again to £T 244 million at the end of May 1942, by which time the note circulation was at £T 598 million. Bank rate is 4 per cent., as it has been since July 1938.

The budget of the U. S. S. R. differs from the budgets of other countries particularly in that, besides the usual government revenue and expenditure, it includes the considerable accounts of the state business enterprises, industry, agriculture and transport, etc., and thus comprehends almost the whole national income. It is rather a balance sheet of the Union's entire economic activity than a budget in the ordinary sense of the word and is the financial means by which the country's resources are distributed between the various sections of the economy: it is the book-keeping aspect of the state-planning programme.

The unified budget estimates (including the Union, the autonomous republics and local bodies) for 1941 showed a total expenditure of Roubles 215.4 milliard (including Roubles 70.9 milliard for armament expenditure) against Roubles 155.4 milliard in 1939; of the receipts to cover the 1941 expenditure Roubles 124.5 milliard, nearly 60 per cent., was to come from the turnover tax and Roubles 13.2 milliard from loans. When hostilities with Germany broke out in the middle of 1941 about one-third of total budgetary expenditure was apparently devoted to armaments expenditure. Since then no statistics have been published but war expenditure must have greatly increased.

Extra resources for the war outlay have been obtained from new taxation (in July and December 1941) and by loans (which, incidentally, directly cut expenditure on consumption, since they are generally subscribed by the workers by deduction from wages at the source); in the first half of June 1941 a 4 per cent. 20-year loan is reported to have produced Roubles 10.8 milliard and in the second half of April 1942 a 2 per cent. loan, also for 20 years, brought in Roubles 12.75 milliard. The total internal public debt was only Roubles 35 milliard in September 1939, but how far the war may have been financed by an increase of the note issue is not known. Indeed, balance sheets of the Gosbank and Treasury returns have not been published since January 1937.

A summary of the **British** *budgetary accounts is given in the following table.*

United Kingdom — Public Finances.

Quarterly in millions of £ sterling	Budget accounts * (cash basis)			War Damage Act — net excess of contributions or *payments*	Net borrowing *(or repayment) (—)*		
	Revenue	Expenditure	Deficit		Long and middle-term	Floating	Total
1939 April–June	144	296	152	—	*—4*	156	152
July-September	194	347	152	—	*—8*	160	152
October-December	206	542	337	—	38	299	337
1940 January–March	505	625	120	—	166	*—46*	120
1940 April–June	188	695	507	—	334	173	507
July-September	264	915	651	—	177	474	651
October-December	300	1,098	798	—	308	490	798
1941 January-March	656	1,159	503	—	315	187	503
1941 April-June	319	1,074	755	—	506	250	755
July-September	418	1,161	743	30	352	361	713
October-December	484	1,260	776	2	571	203	774
1942 January-March	853	1,280	427	*—12*	563	*—124*	439
Financial years							
1939-1940	1,049	1,810	761	—	192	569	761
1940-1941	1,409	3,867	2,458	—	1,134	1,324	2,458
1941-1942	2,074	4,776	2,702	20	1,992	690	2,682
Calendar years							
1940	1,257	3,333	2,076	—	985	1,091	2,076
1941	1,877	4,654	2,777	32	1,744	1,002	2,745

* Excluding self-balancing items and lend-lease; expenditure also excludes sinking fund.

Budget **expenditure** of nearly £4,800 million in 1941–42, as shown in the table, includes sums actually spent in North America (estimated in December 1941 at £300 million for 1941–42) but excludes all transactions under the U. S. Lend-Lease Act; food, munitions and other supplies under this Act were arriving in England at the rate of £100 million a month at the end of the financial year and amounted to some £600 million in all during the year. "Total resources" of all kinds (including lend-lease etc.) amounted to £5,500 million in 1941–42, an increase of 37 per cent. on the "total resources" of £4,000 million in 1940–41. The increase of expenditure on defence is shown in the table on the next page, based on the Exchequer issues during the years concerned.

In 1941–42 the influence of the increase in the public debt outweighed the fall in interest rates, and the debt service rose by 19 per cent.; civil expenditure, however, remained at the level to which it had fallen in 1940–41 (largely as the result of the decline in unemployment assistance*). War expenditure absorbed 85 per cent. of the budget total in 1941–42.

---

* This applies to unemployment assistance given through the budget. The Unemployment Insurance Fund outside the budget was able in 1941 to repay the remainder of its debt contracted in earlier years; at the end of 1941 the Fund had a general reserve of nearly £70 million, to which it was adding at the rate of about £5 million a month (the excess of receipts over administration revenue etc.).

U. K. Budget expenditure.

Financial years in millions of £ sterling	1938—39	1939—40	1940—41	1941—42
Debt service (1)	231	240	230	274
Civil administration (2)	424	429	417	417
Defence and war (3) .	400	1,141	3,220	4,085
Total expenditure.	1,055	1,810	3,867	4,776

(1) Interest and management of the national debt and other Consolidated Fund services (not including sinking fund).
(2) Civil, Roads and Revenue departments.
(3) For 1938–39 and 1939–40: Navy, Army, Ordnance and Air votes, civil defence and issues out of defence loans, plus vote of credit for 1939–40. For 1940–41 and 1941–42 details are not made available but totals are given as issues under votes of credit.

Of the total expenditure of nearly £4,800 million in 1941-42, about £800 million was financed from external resources (including the accumulation of sterling balances by Empire and foreign countries). Of the £4,000 million financed internally, nearly £2,100 million, slightly over 50 per cent., was raised by ordinary revenue, which was 47 per cent. higher in 1941–42 than in the previous year. Of the increase of £665 million in revenue, £430 million was due to direct taxation, £175 million to customs and excise and £60 million to "miscellaneous receipts". Net contributions under the War Damage Act, although very similar in effect to taxation, are held outside the budget; when payments are made they are entered under expenditure in the budget and an amount to cover them is taken into "miscellaneous receipts" from the War Damage accounts. In the last half of 1941 contributions exceeded payments by £32 million, while in the first quarter of 1942 there was an excess of £12 million payments (as shown in the table).

The budget estimates for 1942–43 give war expenditure at £4,500 million and total budgetary expenditure at £5,300 million ("total resources" including lend-lease deliveries probably exceeding £6,500 million); with £800 million financed externally (including the £250 million gift from Canada) some £4,500 million must be financed from domestic resources. Taxation is expected to produce £2,400 million, rather over 50 per cent. and an increase of £300 million on 1941–42; £150 million of this is estimated to come from taxation previously imposed (part of which is only beginning to come into full effect), while new indirect taxation (on beer, wines, spirits, tobacco, entertainments and certain luxuries) has been imposed to produce a further £150 million. The balance of £2,100 million is to be raised by borrowing of domestic resources (against £1,900 million in 1941–42).

The deficit as shown by the budget statistics for 1941–42 rose by 10 per cent. as compared with 1940–41, to £2,700 million. Three-quarters of the necessary borrowing was at long and middle term and only one-quarter at short term.

The amount raised at long term increased by 76 per cent. compared with the previous financial year, a result due largely to the fact that "savings" issues more than doubled. Included under this heading are the various issues made directly to small savers, comprising National Savings certificates (and a small amount of National Savings bonds), 3 per cent. seven-year Defence bonds and 3 per cent. Savings bonds 1955–65; but it excludes small savings

U. K. Government Debt: quarterly increases or *decreases* (—).

Quarterly in millions of £ sterling	Long and middle-term borrowing				Short-term borrowing					Total borrowing
	Savings issues	Market issues	"Other debt"	Total (1)	Ways and Means advances	Treasury bills	Treasury deposits	Tax reserve certificates (2)	Total (1)	(3)
1939 April-June	*—2*	—	—	*—4*	55	100	—	—	156	152
July-Sept.	*—2*	—	—	*—8*	*—34*	194	—	—	160	152
Oct.-Dec.	41	—	—	38	16	283	—	—	299	337
1940 Jan.-March	72	99	1	166	*— 4*	*—42*	—	—	*—46*	120
1940 April-June	88	246	5	334	*—25*	198	—	—	173	507
July-Sept.	88	79 (4)	15	177	55	295	124	—	474	651
Oct.-Dec.	92	213	8	308	45	231	214	—	490	798
1941 Jan.-March	182	129 (4)	7	315	36	60	92	—	187	503
1941 April-June	251	247	10	506	15	145	90	—	250	755
July-Sept.	174	143	38	352	60	220	81	—	361	713
Oct.-Dec.	207	296	63	571	5	*—30*	212	17	203	774
1942 Jan.-March	355	204	8	563	*—57*	74	*—315*	175	*—124*	439
Financial years										
1939-40	109	99	1	192	34	535	—	—	569	761
1940-41	449	667	35	1,134	111	784	430	—	1,324	2,458
1941-42	987	891	119	1,992	23	409	67	192	690	2,682
Calendar years										
1940	339	638	28	985	71	682	338	—	1,091	2,076
1941	814	816	118	1,744	116	395	474	17	1,002	2,745

(1) Less sinking fund; this applies almost exclusively to the long and middle-term debt but, in the quarter January-March 1941, £5 million Treasury bills were redeemed in this way. Total sinking-fund payments were £11.3 million in 1939-40, £17.0 million in 1940-41 and £12.2 million in 1941-42. The total of long and middle-term borrowing also includes some other credit operations of a minor character.

(2) As these certificates may be utilised for payment of taxation after two months' currency, it appears appropriate to include them in the floating debt.

(3) Including movements of Treasury balances, which rarely, however, amount to more than £0.5 million.

(4) Net, i. e. allowing for redemptions amounting to £104 million in July-September 1939 and £100 million in January-March 1940.

made through life assurance companies or by way of savings-bank deposits which may be invested by the institutions concerned in market issues: in the first half of 1941, £120 million of 3 per cent. National Defence loan 1954-58 was specially created and issued directly to the National Debt Commissioners for the investment of savings-bank funds; and in November a further £120 million 3 per cent. Funding loan 1959-69 was created for the same purpose (the surplus of savings-bank funds having previously been employed as a Ways and Means advance to the Treasury).

Besides the two issues just mentioned, all market loans made since the £300 million "War loan" issued in March 1940 have been in the form of 2½ per cent. National War bonds placed "on tap" at par; the first tranche was issued from June to December 1940 and produced £440 million; the second, from January to August 1941, brought in £490 million; and the third, issued from October onwards, had produced £380 million by the end of March 1942; the first two tranches were of 5 to 7-year bonds and for the third the maturity was lengthened to 7-9 years. The "other debt" shown in the table, which previously consisted mainly of voluntary loans made to the government without interest for the duration of the war, expanded in 1941 when the $425 million credit granted by the U. S. Reconstruction Finance Corporation was utilised.

Non-interest bearing loans attained £48 million from the beginning of the war to March 1942 (and during the same period the Treasury had received gifts of £20 million).

The net increase in the short-term debt in 1941–42, by little more than half the increase for 1940–41, was chiefly in the form of Treasury bills, issued in the first half of the year. A new form of short-term debt was created in the Tax Reserve certificates placed on tap at par near the end of December 1941. These certificates, which are untransferable, are intended to absorb funds held in readiness for taxation payments (income tax, excess profits tax, etc.) due not less than two months and not more than two years from the date of purchase; if so utilised, the certificates carry interest at 1 per cent.; they may, however, be repaid after two months, on request, without interest.

The note issue of the Bank of England expanded by £135 million on the year, £81 million being in the last quarter. Although the rate of increase of the note circulation rose during the second half of the year, the date of the return (31st December 1941) partly explains the very high figures. This is true also of the deposits of the banks, included in their "cash reserves", which were unusually large on the last day of the year.

Bank of England Return.

Near end of month in millions of £ sterling	Assets		Total of balance sheet *	Liabilities				
					Current accounts etc.			
	Government securities	All other assets		Notes	Treasury and public departments	banks	other	total
1939, 27th December . . .	728	33	761	555	30	117	42	189
1940, 25th December . . .	805	29	834	617	13	136	51	200
1941, 26th March	754	68	822	612	22	119	52	193
25th June	815	29	844	639	25	113	50	188
24th September . .	857	28	885	671	11	134	52	197
31st December . . .	1,019	35	1,054	752	11	220	54	285
1942, 25th March	961	30	991	755	9	157	51	217

* The combined returns of the issue and banking departments, but omitting duplications due to the holding of a reserve of bank-notes in the banking department.

Government securities, at long and short term, rose by over £200 million during the year. Other assets (market discounts etc.) changed very little on balance and the Bank of England acquired sufficient government securities to cover the expansion of the note circulation and to maintain the bankers' cash reserves at about 10–11 per cent. of their total deposits and current accounts. This is the primary liquidity ratio, or the "cash" ratio as it is traditionally called. In addition, the banks have, in the past, generally maintained a secondary ratio of other liquid assets at about 20 per cent., making a total of cash and short-term assets of around 30 per cent. of their customers' deposits.

The cash ratio is determined by the operations of the Bank of England but the size of the secondary ratio, especially in a period of expansion, depends on the bank's own investment policy and the availability of short-term securities.

London clearing banks' returns.*

At end of month in millions of £ sterling	Assets							Total of balance sheet	Liabilities	Liquidity ratios	
	Liquid assets					Investments	Advances		Deposit and current accounts	primary	secondary
	Cash reserves (1)	Money at call (2)	Bills (3)	Treasury deposit receipts	Cheques in course of collection etc.					in percentages of total deposits and current accounts	
1939 December .	274	174	334	—	106	609	1,002	2,697	2,441	*11*	*21*
1940 December .	324	159	265	314	117	771	906	3,050	2,800	*12*	*26*
1941 March . . .	288	132	194	374	107	821	908	3,006	2,764	*10*	*25*
June	311	143	193	482	137	880	859	3,194	2,946	*11*	*28*
September .	330	134	315	531	100	939	826	3,358	3,115	*11*	*31*
December. .	366	141	171	758	146	999	807	3,582	3,329	*11*	*32*
1942 March . . .	347	137	163	476	122	1,050	838	3,316	3,072	*11*	*25*

* June and December figures are at end of month; March and September are on varying days of the month.
(1) Balances at Bank of England, plus notes and coin in hand.
(2) Money lent to the market at call and short notice.
(3) Nearly all Treasury bills.

The clearing banks' "investments", essentially long and middle-term government securities, rose during the year by £228 million (exceeding the total advances for the first time in banking history); the banks' combined portfolio of short-term government securities (bills discounted and Treasury deposit receipts) rose by £350 million and other liquid assets (cash and money lent to the market, both, in fact, indirectly holdings of government securities) by £24 million, making a total expansion of some £600 million in these items. Since nearly £100 million business advances were repaid, the net expansion of the deposits was about £500 million, i. e. 16 per cent. (The table shows an increase of £529 million in deposits; some £29 million of this amount is, however, a duplication of accounts, due to the rise, from £117 million to £146 million, of the item which includes cheques in course of collection, a result of the slowing-down of the clearing organisation.)

While the cash ratio remained at 11 per cent., the relatively more rapid increase of short-term assets in 1941 caused a rise in the secondary liquidity ratio to over 30 per cent., a record high level. Two reasons have been given by the bank chairmen for this increase of liquidity (which is expensive, in view of the lower level of short-term rates): preparation for a possible withdrawal of deposits on a large scale after the war, and the avoidance of possible capital losses on longer-dated securities. The withdrawal of deposits in the first quarter of 1942, due to payments of direct taxation, was met by by the encashment of Treasury deposit receipts on a large scale, and the secondary liquidity ratio temporarily fell.

The clearing banks, which hold about 85 per cent. of all bank deposits in the country, purchased some £580 million government long and short-term paper in 1941, so that all the banks probably bought around £680 million: with £200 million acquired by the Bank of England, this gives £880 million for the banking system as a whole, rather under one-third of total government issues of £2,700 million during the calendar year.

Market conditions remained very stable in 1941. The quotation of 3½ per cent. War loan rose to 105 (10 points above the fixed "minimum") and the yield fell from 3.2 to 3.0 per cent., while shorter-dated government securities gave yields between 2.0 and 2.5 per cent. As in 1940, there was practically no issue activity in 1941 except that on account of the government. Bank rate was unchanged at 2 per cent. and the discount on Treasury bill issues hardly varied from 1 per cent.

The building societies, one of the most important channels for savings in England, have seen their normal business of financing new building diminish to very small proportions during the war (new advances fell by 77 per cent. in 1940) while their liability for income tax has increased and the need to attract new savings declined: the largest of the societies reduced its rates for deposits and similar borrowing in July 1941 and again in February 1942, the current rates now being from 2 to 2½ per cent. (free of tax). This compares with 2½ per cent. paid for deposits at the Post Office Savings Bank and a yield of 3.16 per cent. (compound and free of tax) on National Savings certificates.

The most remarkable feature of government finances in the United States is the rapid expansion of armaments expenditure.

U. S. Defence Expenditure.

Quarterly in millions of dollars	Army	Navy	Miscel-laneous	Lend-Lease	Total	As percentage of total bugetary expen-diture
1940 Jan.-March	179	224	25	—	428	*19*
April-June	193	273	25	—	491	*21*
July-Sept.	253	342	26	—	621	*27*
Oct.-Dec.	611	498	37	—	1,146	*40*
1941 Jan.-March	1,294	573	35	—	1,901	*53*
April-June	1,479	805	106	21	2,412	*61*
July-Sept.	1,788	1,132	242	243	3,404	*68*
Oct.-Dec.	2,466	1,393	321	646	4,826	*74*
1942 Jan.-March	3,318	1,916	493	1,372	7,099	*82*
Financial year (1)						
1939-40	667	892	99	—	1,657	*18*
1940-41	3,636	2,217	207	21	6,080(2)	*48*
Calendar year						
1940	1,235	1,336	116	—	2,686	*28*
1941	7,027	3,903	703	910	12,543	*66*

(1) Ending June.
(2) Additional expenditure for defence, payable from funds which supplemented regular appropriations of the civil establishments, raised the total for the financial year 1940–41 to $6,301 million.

In the first half of 1940, before the inception of the defence programme of June 1940, defence expenditure had been at the rate of about $ 460 million a quarter; two years later, in the first quarter of 1942, it had risen to over fifteen times this amount. Official estimates made in January 1942 put defence expenditure in the first six months of 1942 at $ 16,000 million, almost double that of the previous half-year and making a total of $24,000 million[1] for the financial year ending June 1942. For the financial year 1942–43 defence appropriations will again be more than doubled at $53,000 million[1]. This geometric expansion of defence expenditure was entirely responsible for the growth of total budgetary outlay in 1941, since other items were not allowed to rise, and in fact declined somewhat, as the following table shows.

United States — Public Finances.

Quarterly In millions of dollars	Budget accounts (cash basis)				Official balances	Total credit financing
	Expenditure		Revenue	Deficit		
	Other than defence	Total	(1)	(2)	(3)	(4)
1940 January-March . . .	1,774	2,202	1,558	644	— *46*	598
April-June	1,826	2,317	1,353	963	— *535*	428
July-September . . .	1,662	2,283	1,489	794	+ 312	1,106
October-December . .	1,712	2,858	1,435	1,423	— *471*	952
1941 January-March . . .	1,684	3,585	2,447	1,138	+ 1,010	2,148
April-June	1,572	3,984	2,235	1,749	+ 40	1,789
July-September . . .	1,597	5,001	1,944	3,057	— *672*	2,385
October-December . .	1,656	6,482	2,222	4,260	+ 2,332	6,592
1942 January-March . . .	1,579	8,678	4,883	3,795	+ 686	4,481
Financial year (5)						
1939-40	7,341	8,998	5,387	3,611	— *1,083*	2,528
1940-41	6,631	12,711	7,607	5,103	+ 890	5,993
Calendar year						
1940	6,974	9,660	5,835	3,824	— *740*	3,084
1941	6,509	19,052	8,848	10,204	+ 2,710	12,914

(1) Net receipts, i.e. total receipts less net social-security employment taxes.
(2) Excluding debt retirements.
(3) Movements of the Treasury's General Fund and of the current accounts of various government agencies with the Treasury (R. F. C., C. C. C., etc.) as well as comparatively small movements on the accounts of certain trust funds (old age insurance, etc.). The movement of the balances shown in this column is affected by changes in the amount of government-guaranteed debt outstanding, especially from the last quarter of 1941, when it was decided to replace this debt by direct government obligations. In this quarter, for example, the accounts of the trust funds and government agencies were drawn down by $1,037 million (when guaranteed debt was repaid); the Treasury's general fund nevertheless increased by $1,295 million, so that the total "movement" was $2,332 million, the amount of direct debt raised in excess of the amount necessary to cover the budget deficit in October-December 1941.
(4) This corresponds to the increase in the gross debt. (5) Ending June.

In spite of the fall in non-defence outlay, total expenditure in the calendar year 1941 was just on double that of 1940, and the budget deficit, which in the calendar years 1939 and 1940 was under $4,000 million, jumped in 1941 to over $10,000 million (the deficit in the last quarter alone exceeding $4,000 million). The deficit for 1941–42 was estimated at $19,000 million and for 1942–43 (taking account of $ 7,000 million new taxation) at $ 35,000 million.[2]

Taxation revenue rose from 1940 to 1941 by one-half but declined relatively to total expenditure during the two years from two-thirds to only one-third. To meet the vast armament outlay a series of fiscal measures has been passed and, as newly-voted legislation came into force, tax receipts rose steeply in the first quarter of 1942, revenue being double what

(1) Later estimates (made near the end of April 1942) place the total defence expenditure for 1941–42 at $26,000 million, while further credits had raised the total for 1942–43 to $67,000 million.
(2) Later estimates of the deficit, due to increased war expenditure, were raised to $49,000 million.

it was in the first quarter of 1941. The original defence law of June 1940 increased direct taxes by about $1,000 million annually; in October of the same year an excess-profits tax was imposed, also to produce nearly $1,000 million. In October 1941 a whole new programme of taxation was passed which, inter alia, broadened the base of income tax to include about double the number of persons; these measures were estimated to add a further $3,500 million annually to taxation revenue. The budget estimates introduced in January 1942 foresee new taxation to produce an annual sum of $7,000 million in addition to $2,000 million of new social-security revenues. (These figures apply, of course, to the Federal or central budget: it is of interest to note that it is only since the inception of the defence programme that Federal expenditures have begun to exceed the aggregate of state and local expenditure, and only in the financial year 1941–42 that Federal tax receipts will exceed aggregate state and local taxation.)

But in the meantime expenditure rose more rapidly than revenue and to cover the mounting Federal deficit it was necessary to make heavier calls on the market than in previous years.

U. S. Government Debt

quarterly increases or *decreases* (—) and totals outstanding.

Quarterly in millions of dollars	Marketable Issues				Non-marketable Issues			Special issues (3)	Gross direct debt (4)	Guaranteed debt (5)
	Treasury bills	Treasury notes	Treasury bonds	Total (1)	Savings bonds	Tax notes	Total (2)			
1940, January–March . . .	— *146*	— *78*	27	— *197*	498	—	495	240	598	— *41*
April–June	— *7*	258	— *353*	— *102*	199	—	191	304	428	— *134*
July–September . . .	1	1	680	683	139	—	132	288	1,105	279
October–December .	7	— *206*	725	526	151	—	146	307	952	109
1941 January–March . . .	294	— *456*	1,572	1,409	404	—	400	313	2,148	— *1*
April–June	— *1*	— *24*	683	659	715	—	711	437	1,788	454
July–September . . .	— *298*	—	— *46*	— *345*	818	1,343	2,210	538	2,385	567
October–December .	697	299	3,198	4,194	1,008	1,128	2,142	324	6,592	— *613*
1942 January–March . . .	— *349*	— *426*	2,542	1,767	2,296	65	2,370	352	4,481	— *634*
Financial year (6)										
1939–40	— *6*	— *860*	1,337	471	1,037	—	1,016	1,005	2,528	78
1940–41	301	— *685*	3,660	3,277	1,409	—	1,389	1,345	5,993	841
Calendar year										
1940	— *145*	— *25*	1,079	910	986	—	964	1,139	3,083	213
1941	692	— *181*	5,407	5,917	2,945	2,471	5,463	1,612	12,913	407
Totals outstanding at end of Dec. 1941 . .	2,002	5,997	33,367	41,562	6,140	2,471	8,907	6,982	57,938	6,324

(1) Including a small amount of postal savings and pre-war bonds.
(2) Including small redemptions of adjusted-service bonds, etc.
(3) Principally social-security issues (old age and unemployment funds, etc.) but includes also issues to government life insurance fund, postal savings system, etc.
(4) Includes a small amount of matured and other non-interest-bearing debt.
(5) Market debt of government corporations and agencies fully guaranteed by the government.
(6) Ending June.

An interesting feature of recent years has been the growing importance of special issues of government securities made directly to the social-security and similar funds and of other non-marketable issues. From June 1936 to

June 1941, the total interest-bearing debt rose by $15,400 million to $48,400 million: only $6,600 million of the increase was in marketable debt, the proportion of which fell from 94 to 78 per cent. of the total. The increase of the gross debt to $58,000 million at the end of 1941 brought it close to the legal limit of $65,000 million; this limit was raised to $125,000 million in March 1942.

In 1941 particular efforts were made to sell government securities to investors other than banks. Two new instruments introduced for this purpose were defence savings bonds and tax-anticipation notes. Defence savings bonds, which were not available for banks, were put on tap from May 1941 in three series with interest rates between 2.5 and 2.9 per cent.; in the first quarter of 1942 over five times as many savings bonds were sold as in the same quarter of 1941. From 1st August two-year tax-anticipation notes were issued in two series, in denominations up to $100 bearing interest at 1.92 per cent. for the small taxpayer, and in large denominations bearing 0.48 per cent. for the big taxpayer; these notes, on which interest is added monthly, are intended to be offered in payment of taxation, but may be redeemed on request (in which case no interest is payable); they are nominative, not transferable, and may not be used as collateral. In the first five months (to December 1941) nearly $2,500 million of these tax notes were issued. Partly as a result of these measures, the non-marketable and special issues of government debt rose by $5,200 million in the second half of 1941 against less than $1,900 million in the first half of the year.

Nevertheless, considerable recourse was had to the open market, issues of marketable securities (i. e. Treasury bills, notes and bonds), which were under $1,000 million in 1940, rose to nearly $6,000 million in 1941: over $4,000 million were issued in the last quarter of the year (when the guaranteed debt declined by over $600 million in accordance with the new policy of replacing the securities of government corporations and agencies by direct government debt). Owing to the large increase of revenue and the success of the savings-bond issue in the first quarter of 1942, market issues were necessary on a much smaller scale.

The member banks of the Federal Reserve System, which had increased their portfolio of government securities (included under "investments" in the table) by $1,500 million in 1940, bought another $3,700 million in 1941.

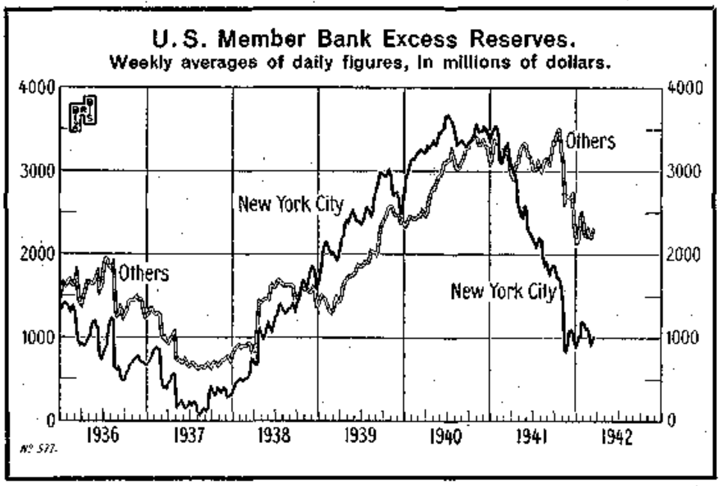
U. S. — All Member Banks.

Near end of month In millions of dollars	Assets			Liabilities
	Reserve balances	Loans	Investments	Demand deposits
1939 December	11,604	13,962	19,979	25,681
1940 June . . .	13,751	13,969	20,482	27,877
December	13,992	15,321	21,806	30,429
1941 March . .	13,531	15,878	23,104	31,576
June . . .	12,959	16,729	23,930	32,678
September	13,246	17,546	24,397	33,822
December	12,396	18,021	25,500	33,754
1942 March . .	12,755	17,822	26,464	.

The banks' government security holdings have been rising since 1930 but their loans and other investments remained at relatively depressed levels until the middle of 1940, from which time a considerable expansion took place. With the inauguration of the defence programme, special efforts were made to put government contractors in touch with the banks and to give advice and assistance in the financing of contracts. In October 1941 an Assignment of Claims Act was passed permitting bank borrowing on the assignment of government contracts. A special enquiry showed that from August 1940 to April 1941 defence loans accounted for nearly one-half of the total increase of commercial loans at city banks; but other loans were also rising in a marked way. This increased lending by the banks and their simultaneous purchases of government securities produced the most rapid expansion of bank credit and deposits ever experienced in the United States. For all the member banks, loans increased by $3,600 million in the 15 months to September 1941 and investments by $3,900 million, while demand deposits expanded by nearly $6,000 million, over 20 per cent. on June 1940.

These developments were viewed with some disquiet, especially since the turnover of bank deposits was also rising, indicating a more active utilisation of existing deposits, and the Federal Reserve authorities took two important measures to check the expansion of credit, with its attendant danger of inflation. In August 1941 the Federal Reserve Board issued regulations for the granting of *instalment credit* (which makes up about one-half of total consumer credit). This form of credit is of more importance in the United States, both absolutely and relatively, than in other countries, about 10 per cent. of all retail sales being made on an instalment basis. It was estimated in 1941 that the record amount of $6,000 million was outstanding in instalment loans (nearly double the low figure for 1938) and that this total was rising very rapidly, apparently at a rate two or three times as great as the expansion of incomes (primarily due, directly or indirectly, to the defence programme). Some 60 per cent. of the business of automobile dealers entails instalment credit, which is also characteristically used for refrigerators, electric stoves and other durable consumers' goods directly competing for plant and raw materials with the armaments industry. The regulations of the Board covered the granting of instalment credit for 24 metal-using commodities, including furniture: the chief effects were to shorten maturity periods for the loans (to 18 months) and to increase the down-payment in cash; the value of used articles given in part-payment was (with the exception of automobiles) to be deducted from the full price and not from the cash payment. In May 1942 the regulations were amended and made more stringent.

The second step taken by the Federal Reserve Board was the raising of *member banks' required reserve balances* from 1st November 1941 by about one-seventh to the maximum allowed by the law, with a consequent cut in "excess" reserves. The total reserve balances of the member banks had grown from $8,000 million in the middle of 1938 to $14,000 million at the end of 1940, largely because the vast imports of gold since the Munich crisis went to increase the banks' deposits and their reserves. Meanwhile the required reserves rose from $5,000 million to over $7,000 million, which meant an expansion of the reserves in excess of requirements from $3,000 million to nearly $7,000 million. At the end of 1940, therefore, about half of the total reserve balances were in excess of legal requirements. But the picture changed in 1941 and excess reserves declined; gold imports, the chief factor in their earlier increase, fell off abruptly, the requirements rose with the expansion of the banks' deposits, while reserves were drawn upon as more money went into circulation. Excess reserves had thus declined to $4,600 million before they were cut in November 1941, by $1,200 million, to $3,400 million (i. e. to less than half their volume at the end of 1940 and to approximately the same level as at the end of 1938).



But the distribution of the excess reserves had changed. At the end of 1938 and of 1940 about half were held by New York City banks and half by other member banks. As the graph shows, the loss of excess reserves in 1941 was heaviest in New York, which held $1,000 million, barely one-third of the total at the end of the year. Consequently the New York City banks, which had added $1,200 million to their government security portfolios in 1940 and a further $1,100 million in the first four months of 1941, did not make any appreciable change in their holdings after the end of April. But member banks in a hundred other cities, which had purchased only $100 million in 1940, continued to buy throughout 1941, adding nearly $1,500 million to their holdings during the year.

During the first ten months of 1941 market conditions were very easy but reductions in rates were slight. Some idea of the weight of money can be obtained from the cash tenders for the four big long-term government issues made for cash during the year.

U. S. Treasury
long-term bond issues 1941.

Date of Issue	Maturity period	Amount offered	Cash subscriptions tendered
	years	in million dollars	
1941 March	11–13	1,020	6,200
June	15–17	1,450	8,270
October	26–31	1,600	10,550
December	26–31	1,100	7,000

The four issues were made at par and interest was at 2½ per cent. per annum in each case: for the first three issues advantage was taken of market conditions to lengthen maturities while raising the amount borrowed; in each case total cash subscriptions rose. For the December issue, made before the United States' entry into the war, the amount offered was lowered and no further lengthening of maturity was made; at the same time a 10 to 14-year issue for $500 million was successfully placed at 2 per cent. The aloofness of the New York banks from the market and the entry of the United States into the war in December caused some fall of quotations and stiffening of rates; the average yield on U. S. Treasury bonds outstanding, which had been as low as 1.88 per cent. in October, rose to 1.97 per cent. in December 1941, and the Federal Reserve banks entered the market to purchase some $70 million government securities (of which $60 million were bonds*). On the outbreak of war in the Pacific the Governors of the Federal Reserve System issued a statement including, inter alia, the following passage: "The system is prepared to use its powers to assure that an ample supply of funds is available at all times for financing the war effort and to exert its influence toward maintaining conditions in the United States Government security market that are satisfactory from the standpoint of the Government's requirements." Nevertheless, quotations continued to be weak in the new year and the average Treasury bond yield rose above 2 per cent. For a $1,500 million 10 to 13-year issue, 2¼ per cent. was offered in February 1942, against 2 per cent. for a similar loan in December. In March 1942 the Federal Reserve banks were authorised to purchase government securities directly from the Treasury (a class of operation hitherto prohibited by the Federal Reserve Act) up to a maximum of $5,000 million.

On the money market also rates were harder at the end of 1941: the yield on 3 to 5-year (taxable) Treasury notes increased from 0.6 per cent. in September to 1.0 per cent. in December, while the discount on 3-month Treasury bills rose from 0.05 per cent. to 0.30 per cent. in the same period. But these rates are still very low and money conditions remain comparatively easy. No changes were made in the rediscount rates of the Reserve banks during 1940 and 1941: against collateral of government securities, seven banks maintain 1 per cent. and the other five 1½ per cent.; for other rediscounts only New York and Boston quoted 1 per cent. and the other Reserve banks 1½ per cent. In March 1942 Chicago also reduced the latter rate to 1 per cent. The Federal Reserve buying rate on 90-day bankers' acceptances (which is more nearly comparable to European bank rates) has remained unchanged at ½ per cent. since October 1933.

In the United States, lend-lease expenditure is included as part of the official budgetary outlay of the Federal Government. If lend-lease deliveries were financed outside the budget, the budget deficit as shown in the official accounts and as given on an earlier page would, of course, be so much less. For example, in the first quarter of 1942, the U. S. budget showed a deficit of $3,800 million, when total expenditure of $8,700 million included $1,400 million for lend-lease financing; without lend-lease the deficit would have been $2,400 million. Lend-lease deliveries are made without monetary obligations

* Further action was taken to support the market in 1942, particularly in April and May, in which two months nearly $250 million of government securities were purchased by the Reserve banks.

arising between the partners, but even so, exactly the same internal financing is necessary for the party making the deliveries.

Internal financing, similar to that involved by the lend-lease procedure in the United States, is a necessary concomitant in India and Canada to the accumulation of sterling assets (whether such financing is included in the budgetary accounts or not). The financing of the budget deficit and of the sterling balances of these two countries must, therefore, be considered as a single problem. A rough idea of the proportions involved is given by the accompanying round figures in sterling. In each case the financing of the accumulation of sterling is greater than the borrowing necessary to cover the domestic budget deficit, this deficit in India being relatively small.

India and Canada
public internal financing by credit,
from the outbreak of war to December 1941.

In millions of £ sterling	India	Canada
Government borrowing necessitated by:		
sterling accumulation (1)	230	300
internal budget deficit (2)	20	175
Total internal financing by credit	250	475

(1) Sterling balances and securities, redemptions and repatriations of loans, etc.
(2) As the period shown does not coincide with the financial years, rough estimates only are available.

The situation is, however, oversimplified in the table: Canada has a passive balance on account with the United States which India has not; Canada does not receive lend-lease aid (but has a special arrangement) while India does; Canada is now making free deliveries of armaments to England whereas, by an agreement made in September 1941, India is receiving essential equipment and war supplies free of charge from England.

Details of the internal financing have also differed greatly in the two countries, largely owing to the fact that Canada possesses a modern banking system and capital market in a sense that India does not. In India the sterling assets are currently purchased directly by the central bank, while in Canada sterling is bought by a government agency which borrows against it from the central bank only such Canadian dollars as may be temporarily required pending the issue of internal loans. To facilitate repatriations of Indian sterling securities, rupee counterparts have been created (with similar interest rates and other conditions); in Canada new loans are issued to cover both the budget deficit and the accumulation of sterling.

The growth of the sterling assets of the Reserve Bank of India has been regular and continuous. Up to December 1941, only once was there an appreciable decline — when £65 million of Indian sterling securities were repurchased in March 1941. Over the whole period, from the outbreak of war up to the end of 1941, the Reserve Bank increased its holding of sterling by over £150 million, which (with a small increase of government securities) accounted for nearly two-thirds of the government's total internal financing requirements.

The expansion due to the acquisition of sterling had its counterpart chiefly in an increase of the note circulation by £110 million and the issue of £30 million rupee coin. Further, the cash reserves of the scheduled banks rose to about three times their former level.

Reserve Bank of India.

Monthly averages in millions of £ sterling (1)	Assets					Liabilities		
	Gold (2)	Sterling assets (3)	Rupee assets: government securities	Rupee assets: coin	Rupee assets: total (4)	Notes	Deposits: government	Deposits: banks
1939 August	66	48	28	56	91	135	18	10
December	66	80	28	50	92	172	10	12
1940 December	66	139	37	22	66	178	12	37
1941 December	66	202	32	26	66	244	15	28

(1) Conversion has been made all through at 1 rupee = 1s.6d.
(2) At current price.
(3) Sterling balances and securities (mostly Treasury bills).
(4) Including some other rupee assets.

The assets of the Bank of Canada, since its gold and dollar holdings were taken over by the Foreign Exchange Control Board, consist of government assets, in one form or another, to over 95 per cent.

Bank of Canada.

End of month in millions of £ sterling (1)	Assets					Liabilities		
	Gold	Sterling assets (2)	Canadian assets: government securities (3)	Canadian assets: other	Canadian assets: total	Notes (4)	Deposits: government	Deposits: banks
1939 August	48	12	37	2	39	41	7	46
December	51	15	53	1	54	53	11	49
1940 December	—	9	131	3	134	82	2	49
1941 December	—	46	138	8	146	113	17	53

(1) Conversion has been made all through at Can.$4.4 = £1.
(2) Including U. S. dollars up to April 1940.
(3) At the end of April 1940 $250 million (£57 million) of government securities were acquired by the bank in exchange for the gold and dollar holding.
(4) There is also the note circulation of the chartered banks, which was reduced over the period shown from £21 million to £17 million.

The sterling purchases of the Bank of Canada have been relatively small and irregular: the sterling holding grew to nearly £70 million on 25th June 1941 and by the end of that month had fallen below £1 million; again, an accumulation of over £100 million on 25th March 1942 was reduced in two steps to under £1 million early in June. These movements of the sterling holding do not coincide with purchases of sterling by the Foreign Exchange Control Board but only with the Board's current needs for Canadian dollars, and they are thus only another form of current government borrowing. In fact, to offset the temporary expansion which would otherwise occur, the Bank of Canada has sold government securities on the market as the Board sold sterling to the bank (with a repurchase agreement) and vice versa.

But the bank has, on balance, increased its lending to the government (through the purchase of securities and sterling) by some £80 million from the outbreak of war to the end of 1941 (less than one-fifth of the government's total internal financing over the period); the note issue has risen by over £70 million and the balance is largely shown by an increase of the deposits of the government and chartered banks. Of the increase of the note issue, over £10 million was taken into the tills of the chartered banks, whose cash reserves thus rose more than is shown by their deposits at the Bank of Canada. The remainder of the government's requirements (under £400 million or, say, Can.$1,700 million) has been financed by market issues. Three war loans have produced about $1,250 million new money: 3¼ per cent. 12-year bonds at par in January 1940; 3 per cent. 12-year bonds at 98¾ in October 1940; 3 per cent. 10-year bonds at par and 2 per cent. 5-year bonds at 99 in June 1941; the residue was largely covered by short-term notes and Treasury bills issued for the most part to the banks.

In Canada about 60 per cent. of the expansion of central-bank credit went into the active note circulation (the small coin holding being unchanged), while in India the issue of notes and coin corresponded to over 90 per cent. of the expansion. The great difference in monetary effort lies, however, in the action of the commercial banks. In India, although the deposits at the scheduled banks rose between August 1939 and December 1941 from the equivalent of £190 million to £260 million, there was, on balance, an expansion of discounts and advances by only 10 per cent. (from £82 million to £90 million). On the other hand, the Canadian deposits with the chartered banks rose during the same period from the equivalent of £580 million to £700 million, current loans to the public expanding by over 30 per cent. from £190 million to £250 million. To check unessential private borrowing in Canada, stringent regulations were issued limiting the extension of instalment-purchase finance in October 1941.

In the four financial years to March 1941, which cover the period since the outbreak of war with China in the middle of 1937, Japanese war expenditure aggregated Yen 23,800 million, some 70 per cent. of total budgetary expenditure of Yen 32,700 million. The accumulated deficit in these years amounted to Yen 19,600 million and was covered by internal bond issues of an approximately equivalent sum. Increased debt service was the principal cause of the rise of other expenditure; the Ministry of Finance accounted for Yen 440 million in 1936–37 and Yen 1,910 million in 1940–41, an increase of Yen 1,470 million out of an increase of Yen 2,070 million for all expenditure other than that incurred directly for war.

Taxation receipts in 1940–41 were three times as great as in 1936–37, and total ordinary revenue in the four years was around 40 per cent. of total expenditure. New legislation, estimated to produce over Yen 2,000 million new revenue from taxation, was passed in two bills in November 1941 and January 1942.

The 1941–42 budget estimates shown in the following table were drawn up before the outbreak of hostilities in the Pacific, which naturally led to a sharp rise of war expenditure. In the nine months to December 1941 bond issues totalled

Japanese budget accounts(1) and internal government debt.

Financial year to end March in millions of Yen	Expenditure(2)			Revenue(3)			Deficit	Internal bonded debt	
	War	Other	Total	Taxation	Other	Total		Total (4)	Increase in financial year
1936–37	1,078	1,204	2,282	1,051	712	1,763	519	9,258	735
1937–38	3,777	1,471	5,248	1,431	878	2,309	2,939	11,517	2,259
1938–39	6,017	1,804	7,821	1,984	925	2,909	4,912	16,065	4,548
1939–40	6,234	2,330	8,564	2,495	1,177	3,672	4,892	21,628	5,563
1940–41	7,764	3,270	11,034	3,164	1,046	4,210	6,824	28,611	6,983
1941–42	8,130	4,075	12,205	3,691	1,300	4,991	7,214	39,250	10,639

(1) Based on data given in the Mitsubishi Monthly Circular for April 1941: closed accounts up to 1939–40, estimates (including supplementary) for 1940–41 and estimates for 1941–42.

(2) Combined budgets. War expenditure in the table comprises the Temporary War Expenditure (China Incident) Account and also includes defence expenditure in the general (ordinary) budget.

(3) General budget. (4) At end of March (excluding the rice-purchase notes and silk bills).

over Yen 7,500 million (thus exceeding the estimated deficit for the whole year) and a further Yen 3,000 million were issued during the three months January–March 1942 (almost double the amount for the same quarter of 1941), so that the total deficit was over Yen 10,500 million. For 1942–43 the ordinary budget amounts to Yen 8,837 million, while Yen 18,000 million of new war credits have been voted, making total estimated expenditure of over Yen 26,800 million; government bond issues of Yen 16,300 million have been authorised so that, with unused authorisations of over Yen 4,000 million, total issues may exceed Yen 20,000 million in the current financial year.

The monetary effects of these issues will depend largely upon the amount of bonds which can be placed outside the Bank of Japan. To indicate the experience of recent years the accompanying table has been prepared for calendar years.

Japanese internal bonded debt.(1)

Calendar years in millions of yen	Total internal bonds (2) outstanding	Increase on year	Taken by	
			Bank of Japan	other investors
1937	9,070	860	560	300
1938	14,930	5,860	450	5,410
1939	20,250	5,320	580	4,740
1940	27,000	6,750	1,530	5,220
1941 (3)	36,260	9,260	1,390	7,870

(1) In addition external bonds are outstanding (the amount falling by Yen 200 million to Yen 1,220 million in the period covered by the table). (2) At end of year. (3) Provisional.

The issue of bonds in the calendar year 1941 alone was slightly more than the total outstanding at the end of 1937. The most difficult year was, however, 1940, when the Bank of Japan had to take up over Yen 1,500 million, i. e. nearly as much as in the previous three years together. In the autumn of 1940 steps were taken to ensure the more ready cooperation of the other Japanese banks and in 1941 the Bank of Japan had a smaller amount left on its hands; in spite of a large issue it took up only 15 per cent. of the total, against 23 per cent. in 1940. This was the more remarkable in that issues of corporation and local government bonds also increased (from Yen 2,508 million in 1940 to Yen 3,749 million in 1941).

Other changes in the return of the Bank of Japan are shown below.

Bank of Japan balance sheets.

At end of month in millions of yen	Assets							Total of balance sheet	Liabilities		
	Gold (1)	Foreign ex-change (2)	Special fund for foreign ex-change (3)	Ad-vances on foreign bills	Govern-ment bonds	Bills dis-counted (4)	Agen-cies ac-counts		Notes issued	Govern-ment depo-sits	Cur-rent ac-counts
1936 December	548	51	—	159	829	586	34	2,512	1,866	227	129
1937 December	801	52	—	163	1,387	465	57	3,039	2,305	303	132
1938 December	501	55	300	51	1,841	457	110	3,477	2,755	286	131
1939 December	501	52	300	255	2,417	810	198	4,725	3,679	547	162
1940 June	501	46	300	112	2,547	834	235	4,762	3,597	610	152
December	501	64	300	143	3,949	676	289	6,141	4,777	738	229
1941 June	555		300	30	3,847	543	339	5,866	4,247	791	341
December	525		300	52	5,340	852	465	7,727	5,979	794	445

(1) Gold coin and bullion (including a very small amount of silver) until December 1940.

(2) In 1941 the separate item of foreign exchange (Foreign Agencies accounts) was omitted from the balance sheet, while the reserve item was renamed "Bullion and Foreign Accounts".

(3) This is the so-called "revolving fund" created in 1938; details of its composition and working have not been published.

(4) Bills discounted include the item "Bills discounted, Law No. 55 of 1927", which has declined from Yen 472 million to Yen 249 million over the period covered in the table.

The outstanding features of the returns since 1936 are the increase of over Yen 4,500 million in government bonds, of over Yen 4,000 million in the note circulation and nearly Yen 900 million in total deposits and current accounts: Yen 1,500 million of the expansion of the government bond portfolio took place in the second half of 1941, after some contraction in the first half of the year.

The increase of "current accounts" in 1941 was due chiefly to balances formed by the paying-in of notes by the Banks of Chosen and Taiwan (whose reserves may now be held in this form instead of in notes of the Bank of Japan, as previously was the case). Because of the rise in the note circulation, the expansion of the Bank of Japan's credit to the government through bond purchases has not led to any appreciable increase in the cash reserves of the commercial banks with the Bank of Japan, also held under "current accounts".

Japanese financial institutions.

Financial year	Annual increase of deposits in millions of yen
1938–39	7,330
1939–40	10,200
1940–41	12,810
1941–42	16,020

As by far the greater part of the government's financing is done through banks and other financial institutions (which, including the Bank of Japan, hold about 85 per cent. of the government bonds outstanding) the accompanying table, showing the increase of deposits at these institutions, is of particular interest.

Long-term rates are indicated by the conditions of issue of government bonds, which have remained as before — 3½ per cent. 11 to 17-year bonds issued to give a yield of about 3.65 per cent. Bank rate (the rate for the discount of commercial bills) has remained at 3.285 per cent. since April 1936; and the same rate has applied since July 1937 to bills with government-bond collateral, i. e. a rate less than the yield on the bonds themselves.

As part of the new economic-structure plan adopted in December 1940 to place the whole country on a war footing, the government announced a new financial and monetary policy in July 1941. The chief points are:

a) the allocation of total resources, based on estimates of the national income, and the determination of bond issues according to the market's capacity to absorb them,

b) the revision of the budgetary accounting system, involving the allocation of quotas to the various branches of government,

c) the mobilisation of funds through the control of the Bank of Japan over business and banking,

d) the revision of taxation to produce new resources and curb consumption, and

e) the extension of state guarantees for the utilisation of idle industrial equipment and the construction of new plant etc.

Various parts of this plan are already in force, including the extension of the powers of the Bank of Japan and the creation of a Wartime Financing Bank (see Chapter VI). The capital-mobilisation plan for the financial year 1942–43 is based on an estimate of the national income at Yen 45 milliard (against Yen 25 milliard in 1939 and Yen 32 milliard in 1940): the government plans to take Yen 24 milliard (8 milliard as ordinary income and 16 milliard by borrowing), Yen 6 milliard is allocated to investments for the increase of production and Yen 15 milliard to private consumption. In April 1942 a new Financial Control Association was set up, with the president of the Bank of Japan as its head, to frame the state financial policy and cooperate in its execution.

Although much has been written on the sources of war financing and the various related problems which have to be faced alike by all belligerents, questions regarding the technique of borrowing appear to have been comparatively neglected. In the first place it is necessary to distinguish between loans to which subscriptions are entirely voluntary and forced loans, the conditions of which may involve varying degrees of compulsion for the subscriber. Generally, the difficulties placed in the way of current spending in wartime, the smaller supply of goods for consumption and their rationing have forced individuals to "save" simply because they cannot spend; and, as other borrowers are largely excluded, the government benefits directly or indirectly by this saving. Recently, to close up loopholes and to tie up loose money, some element of compulsion has crept into the lending of surplus funds to the governments.

In Germany participation in the new form of "iron savings" is voluntary, although, once the worker has indicated his rate of saving, he is bound to it for at least three months and his savings are tied up until a year after the end of the war. Further, amounts surrendered by industrial entreprises in virtue of the new regulations regarding "profit skimming" are to be accumulated in a profits surrender account, the utilisation of which will be decided upon by the Reich Minister of Finance after the end of the war; the amount surrendered may, to the extent of 50 per cent., be restored, or a respite for its payment be granted, to the entrepreneur if he is able to prove that he needs these resources for reasons of war economy, or owing to special economic difficulties (3½ per cent. interest being paid on amounts thus restored). Since the budget of 1941, in England a system of "forced" savings has been coupled with the broadening of direct taxation: before the war just under one million workers paid £2½ million in income tax while in 1941–42 income tax had been extended to 5½ million workers, who contributed £125 million; but of this amount some £60 million was treated as post-war credits, i. e. was credited to the taxpayer in a savings account to be repaid after the war. Similarly, although the Excess Profits Tax on companies is now levied at 100 per cent., 20 per cent. of this is to be returned to the taxpayer after the war, subject only to its not being used for dividends or for the issue of bonus shares. Measures taken in May 1942 introduce somewhat similar principles in Italy: all excess profits due to the war, i. e. the difference between present and normal profits, less the amount already paid in extra taxation and a smaller amount representing a fraction of the ordinary profit, are to be compulsorily invested in a special type of 3 per cent. nine-year Treasury certificate registered in the name of the owner, which will not be transferable before the end of the war. The employment of the sums in question will be decided upon when the war is over, preference being given to payments for plant for reconstruction purposes and to the reconstitution of stocks. A further measure provides that, upon the establishment of new share companies or capital increases of existing companies, at least 20 per cent. of the subscribed or new capital must in future be invested in non-transferable 3 per cent. Treasury certificates; in the case of bonus issues, an amount equivalent to 50 per cent. of the nominal value must be so invested within one month.

From the examples given it will be seen that in Germany, England and Italy compulsory loans to the government for the duration of the war are closely related to taxation on the excess profits of companies. In Italy subscriptions to government bonds also are linked to the acquisition of new cash resources from share issues. Smaller forced savings in England are based on the rate of income tax, and some such criterion as regards subscriptions is not unusual, the amount of the compulsory subscription being related to current taxation or income. In New Zealand contributions to the compulsory loan of September 1940 were to equal income tax paid in 1938–39 in excess of certain given amounts. The forced loans which, following the precedent of the war of 1914–18, have been threatened in Holland (but not issued since the threat was sufficient to make "voluntary" loans successful) were based upon the amounts paid as tax on net fortunes.

During 1941 forced government loans were made in Bulgaria (see page 153), Roumania (see pages 154–155), Slovakia (see page 156), and Turkey; and early in 1942, in Croatia and Greece. The standards upon which the compulsory subscriptions have been based show great variety. A favourite form is a proportion of the reserve funds (or other assets) of share companies (Bulgaria, Roumania, Turkey and Croatia). The liquid funds of the banks are also a temptation to governments in need and may be forced into government securities either indirectly (as in Slovakia, where the banks have to make deposits with an institution to "support" the government securities' market) or directly (as in Greece, where part of the banks' cash reserves have been taken over and they are forced to reconstitute their liquidity position through the issue of Kassenscheine). The greatest variety, however, has been shown in Roumania, where forced subscriptions to the Unification loan were based inter alia on one year's taxation (for property-owners and industrialists), on one month's salary (for officials) and on the area of land (for peasants).

In some countries where no forced loan has been issued, certain funds may be invested almost automatically in government securities: this is true in general of extra-budgetary funds, unemployment relief and social insurance etc. And the laws limiting dividends are often supplemented by provisions requiring the investment in government securities of funds which, but for the dividend limitation, would be available for distribution. Further, a certain atmosphere of compulsion may exist through the various forms of "direction" and "guidance" given to institutions by official quarters as regards investments. In Holland a decree published in May 1942 prescribes that institutional investors (savings banks, insurance companies, social funds etc.) must restrict their investments in mortgages in order to invest larger amounts in government loans; and in other countries the central bank has powers to ensure the "cooperation" of the commercial banks in taking up government issues (as in Japan).

Turning now to the issue of voluntary loans, it is interesting to observe how the technique of "tap issues" has progressed in Germany and England, in contrast to the "war loan" technique of the United States and Italy and, indeed, most other countries. In the United States, for example, there are no tap issues of marketable securities; long and middle-term issues of Treasury bonds and Treasury notes are made for specific amounts, generally on the regular financing dates in March, June, September and December. The total to be issued is fixed beforehand and the lists closed when this amount has been subscribed; the success of the issue depends largely on market conditions, which, in wartime particularly, may be temporarily disturbed by passing events.

In Germany and England, however, government long or middle-term borrowing is continuous. In Germany all market issues since the war have been in the form of Treasury certificates which may be purchased at any time. Each year a new loan has been made, in 1940 at 4 per cent, in 1941 at 3½ per cent.; a number of tranches of each loan are issued, generally for a month or two at a time, and the issue price and maturity dates are varied (the issue price being generally raised while the term of the certificates has been lengthened from 5 to 20 years).

One "war loan" in the old style was issued in England in March 1940, but since then all issues have been of middle-term National War bonds placed on tap for six months or so at a time; issues have all been made at par with a uniform rate of interest of 2½ per cent., while the maximum maturity has been lengthened from 7 to 9¾ years. But whereas issues in Germany have been continuous and the Reichsbank has exercised supervision over the government bond market, buying and selling from time to time (as have the Federal Reserve Banks in the United States) to maintain uniformly regular conditions, the continuity of the issues in England was broken for two months (mid-August to mid-October) in 1941 when no new issue was on tap. During this period a breathing-space was allowed, the weight of money on the market increased, old issues were well supported and the new loan eagerly awaited. This form of market control, combined with fixed minimum prices for government bonds and open-market operations with Treasury bills, is preferred in England to the direct purchase of long-term government securities by the Bank of England to support the market.

An interesting combination of "tap" and "war loan" technique has developed in Australia (and more recently in New Zealand). In order to mop up money as it becomes available, subscriptions to the next war loan are invited before the terms of the loan are announced: interest is paid on these advance subscriptions at the rate specified when the prospectus is published; if investors are dissatisfied with the terms they may withdraw their subscriptions — but, in this case, they receive no interest.

In addition to the technique of issue, the actual form the security takes is not without importance. Long-term government loans in England have in the past been issued in three forms: bearer bonds, transferable by the passing of possession of the security; registered stock, the certificate for which is nominal and transferable by deed; and inscribed stock, represented by no tangible security but only by an entry in the books of the Bank of England. Inscribed stock, the transfer of which requires the personal attendance of the investor, or his representative, at the Bank of England, was generally less popular than the bearer bond or registered stock and in wartime appears to have been little used, although government issues made provision for this form of investment. In October 1941, for the first time, the new tranche of 2½ per cent. National War bonds was issued only in bearer or registered form, and the gradual disappearance of inscribed stock appears to be foreshadowed.

This wartime evolution is of interest since it is the opposite of what has happened in Germany. The "noiseless" government financing through institutions in that country has led to the development of government borrowing by book entries, without the actual issue of bonds or other securities. The first step was taken as early as 1938, when subscribers to the third issue of 4½ per cent. Treasury certificates were offered, in addition to the usual choice between bearer bonds and nominal stock, the possibility of collective deposit at a Wertpapiersammelbank (an institution specialising in stock-exchange-security deposit business). Since the bulk of the deposits remained there until redeemed, the issue of individual securities was superfluous and the Reich introduced global certificates.

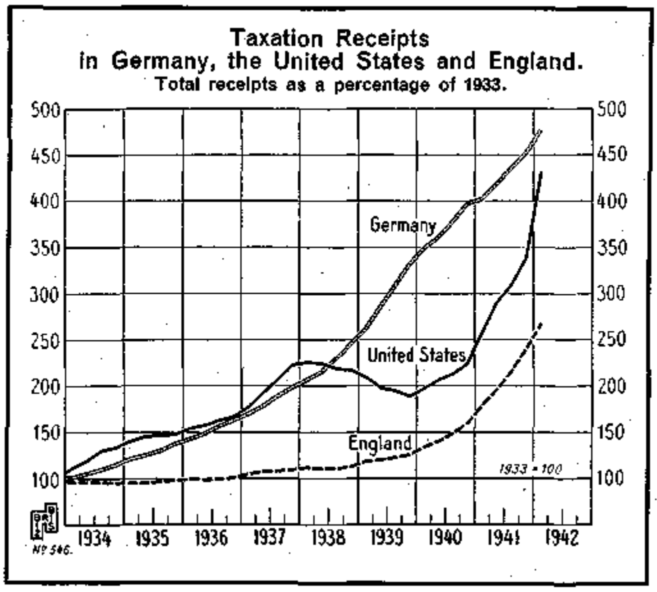
The next step was made in 1940 from collective deposit to collective administration by dispensing with the global certificate; the Wertpapiersammelbank thus ceased to be a depositary and became an administrator of claims. Legally the Wertpapiersammelbank was the creditor of the Reich and had sole right of disposal of the claim, becoming trustee for the banks which were its principals, while they, in their turn, were trustees for their customers. Under this system all transfers, interest payments and loan redemptions are made by book entries. As amortisation by repurchase on the market or by drawing individual securities is unsuitable for collective administration, the Reich changed its technique, redemptions being made by drawings in small groups. A further considerable step was taken with the decree of 31st December 1940, which made collective-administration components good delivery on the stock exchange (a measure of great importance as regards marketable Treasury certificates although not much affecting the non-marketable Liquidity loans). And a far-reaching measure of rationalisation was decided upon in March 1942, when it was announced that the Reichsbank would take over and centralise the entire collective-security deposit and administration business previously done by the Berliner Kassenverein and the ten other Wertpapiersammelbanken in the country. In May 1942, the shares of the Berliner Kassenverein were exchanged partly for shares of the Reichsbank and partly for Reich securities.

The progress made by the new system may be realised from the following figures: In 1938 only 10 per cent. of the eligible issues were entered in the debt register; in 1940 the percentage was 64 (90 per cent. for Liquidity loans and 36 per cent. for Treasury certificates); in 1941 the percentage was 97 for Liquidity loans and rose from less than 60 for the first tranche of Treasury certificates to 80 for the fourth tranche. In the war of 1914–18 the issue of RM 97 milliard war loans necessitated the issue of 64 million separate bonds and 1,300 million interest coupons; with issues of some RM 34 milliard in 1940–41 this would have meant about 23 million bonds; actually only 3.2 million bonds were put in circulation, a saving of nearly 20 million bonds and the annual manipulation of 40 million interest coupons. There is thus an immense saving of labour and material for the Reich Debt Administration, while it is maintained that the individual investor gains in convenience, in punctual collection of dividends, in security against loss and in costs of safe custody.

With all their various techniques of issue and different forms of security holding in the principal belligerent and some other countries, it has been possible, in striking contrast to the last war, gradually to improve the terms of borrowing for the government, or, in other words, slowly to change the terms of goverment loans to the disadvantage of the subscriber, who thus has no incentive to wait in the hope of higher rates.

The level of interest rates during the war determines the permanent cost of the new long-term debt and the current cost of the floating debt. If interest rates rise after the war, the cost of renewing and consolidating the floating debt will also increase. The "burden" of the public debt will depend, however, not only upon interest rates but upon prices both now and after the war (and, indeed, upon all the factors affecting the national income) and also, of course, on the size of the debts. The internal public debt in England, which was £6,300 million in 1931, had reached nearly £13,000 million in March 1942; the internal (post-1924) public debt of Germany was RM 4 milliard at the end of 1932, RM 30 milliard in August 1939 and RM 121 milliard in December 1941. The total internal debt of Japan, which was under Yen 10 milliard in 1936 (before the outbreak of hostilities with China), had risen to Yen 36 milliard at the end of 1941; the United States Federal debt was under $20 milliard in 1932, nearly $43 milliard in June 1940 (the beginning of the defence programme), and $58 milliard in December 1941. But in the United States the public debt at the end of 1941 was still well below the equivalent of one year's national income; for Germany and Japan they were about equal; the Italian public debt was more than one year's income and less than two, while the English public debt was already double the annual national income.

Since interest rates have generally fallen the service of the debt has not risen in the same proportions as the debt itself, but the debt service, at present, absorbs one-tenth of taxation revenue in the United States, rather over one-tenth in Germany, about one-sixth in England and one-third in Italy and Japan. In his budget message to Congress in January 1942, the President of the United States said that the Federal debt would increase to $110 milliard by June 1943 and that this growth of the debt would require an increase in the annual interest service from $1 milliard in 1940 to above $2.5 milliard in 1943. "Such an increase in interest requirements", he said, "will prevent us for some time after the war from lowering taxes to the extent otherwise possible."



Quarterly figures on basis of 1933 (equals 100). A moving average of four quarters has been taken (to eliminate seasonal movements) centred on the fourth quarter, which thus gives the average for the year.

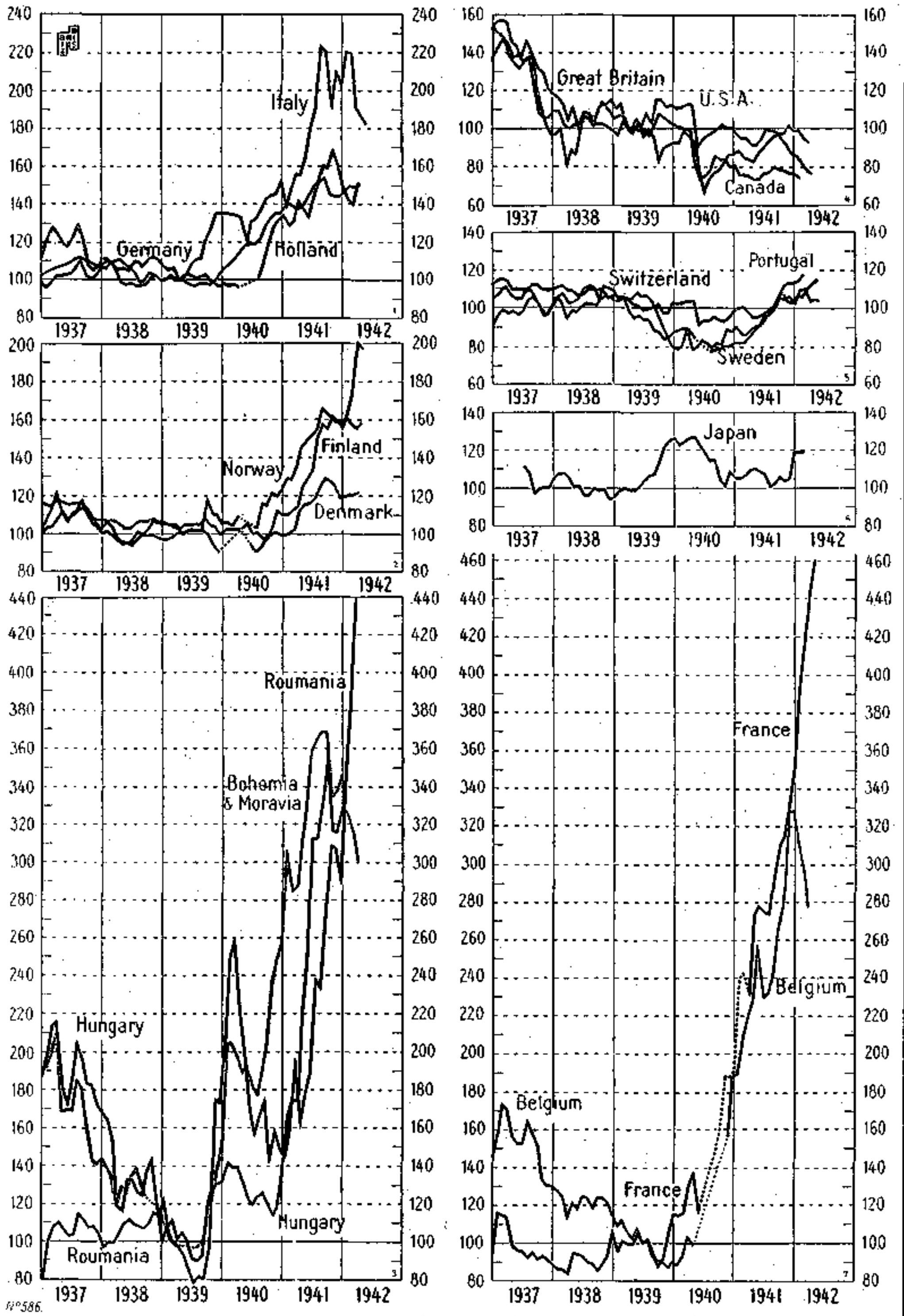
To illustrate the development of the revenue from taxation in recent years the two graphs which follow have been prepared. They show the steady increase of German taxation receipts since 1933 and the sharp rise of revenue in the United States and England in more recent years. In 1941 taxation in Germany produced 4½ times as much as in 1933; in the United States 3½ times and in England 2½ times. The years 1932–33 were in most countries the lowest point of the great depression and in all countries the proceeds of taxation increased with the expansion of business activity. The lower rise shown for England, however, is due to the relatively stable revenue from taxation in that country and to the choice of 1933 as base year: from 1929 to 1933 English receipts from taxation actually rose by 2 per cent. whereas they fell in Germany by 25 per cent. and in the United States by 38 per cent.

Each quarter's taxation receipts have been compared with the same quarter of the previous year and the result shown as a percentage increase (or decrease). Moving average of four quarters as above.

The second graph, which gives a delicate measure of the rate of growth, is remarkable for several reasons, amongst which may be mentioned the steady 20 per cent. increase in Germany in the years before the war when the rate of increase in England, and more particularly in the United States, fluctuated as a result of changes in business activity. The movements of government revenue in the United States are typical of the elasticity in the economy of that country; taxation receipts declined after the boom of 1937 (when the "rate of increase" fell below zero in 1938) but from the end of 1939 there has been a mighty increase. Price movements are of course important for their effect on the revenue from taxation and in this connection the rise in wholesale prices in England by some 50 per cent. since the outbreak of the war should be remembered.

In conclusion: a further year of war has not produced any essentially new problems of government financing; but the strain has been intensified by the rise in the proportion of military expenditure to total national resources and by the more comprehensive financial operations which consequently have become necessary. While financial considerations are not allowed to hamper the war effort, it is increasingly realised that recourse to inappropriate methods may be a source of much immediate and future trouble. Hence, increasing stress is laid on the fact that the problem of withstanding inflation should be attacked not only from the goods side but also from the money side, not only by price control and its auxiliary, the rationing system, but also by measures designed to absorb excess purchasing power. There has been a certain shift from a one-sided insistence on the advantages of cheap money to greater emphasis on the desirability of stability in the credit structure and the need to tie up temporary "savings" so as to prevent their eventual release from adding to the excess of purchasing power at a time when this would be likely to complicate the already sufficiently difficult post-war monetary problems.

Share Indexes, January-June 1939 = 100.



2. SHARE MARKETS.

As official control tightens and spreads, so the "free sector" diminishes in size and importance; but it still retains considerable interest as a barometer, generally difficult to read, however, since organised and up-to-date statistics are difficult to come by. The particular interest of share markets at the present time lies in the fact that, for various reasons, this is one of the last free markets to come under control, and current statistics of quotations and yields are available for study. But "freedom" becomes more and more a relative term even here, and in 1941 control spread further into this field than ever before.

Foreign exchange control and other factors have practically eliminated international arbitrage, so that foreign purchases and sales had little or no effect on quotations except in particular cases, the most important of which were German purchases on the Dutch market after the abolition of the "blocked-mark" tax on 1st September 1941. In December 1941 and the following months, Japanese successes provoked a sharp slump of colonial shares in Amsterdam and London. But, in general, domestic influences were everywhere of preponderating importance, particularly credit conditions and the pressure of surplus purchasing power. To illustrate movements of share quotations, the graphs on the opposite page have been prepared and data on which they are based are summarised in the following table.

Share Indexes.

On basis of January-June 1939 = 100	Position of index at end of		
	1939	1940	1941
Paris (1)	116	191	353
Prague	146	253	342
Budapest	129	134	327
Brussels	81	150	322
Bucarest	173	148	290
Milan	134	161	201
Oslo	102	120	156
Amsterdam	92	127	156
Helsinki	90	110	155
Berlin	103	135	144
Tokio	126	105	119
Copenhagen	94	94	113
Lisbon	100	95	110 (2)
Zurich	87	82	102
London	93	87	98
Stockholm	75	82	97
New York	108	96	81
Montreal	101	77	73

(1) For the period 1940-41, when the Paris market was closed, the index has been based on data available for Lyons. (2) Provisional.

Most of the original indexes are published officially or semi-officially; for comparison they have been recalculated on a pre-war base (first half of 1939 = 100). Quotations in New York fell by over 15 per cent. in 1941, the decline continuing into 1942 until, in April, the lowest level since 1935 was reached. In 1941, Montreal was also lower. All other stock exchanges were higher, in some cases much higher on the year.

At the end of 1941 share indexes in the United States, England and the Dominions were at or below the pre-war level; the same was more or less true of the three continental neutrals, Portugal, Sweden and Switzerland. In Germany share quotations had risen some 40 to 50 per cent. above the pre-war level; in Italy they had doubled; in France, Belgium and south-eastern Europe the rise amounts to 200 per cent. and more. Many of the continental European indexes, with the notable exceptions of Paris and Bucarest, reacted in the first three months of 1942, but they remain above the highest points reached in the relatively prosperous year 1937, while many exceed the records of 1927-29, when American capital was pouring into Europe.

In making international comparisons of this nature there are at least three important considerations to take into account: the size of the market, its turnover, and the construction of the share index. The market valuation of all shares quoted around the end of 1940 was approximately as follows: New York, over $40,000 million; London, probably $20–25,000 million; Berlin, some $5,200 million; Amsterdam, $2,400 million; Zurich (and other Swiss exchanges), $540 million; other European markets are generally much smaller, e. g. Budapest, $150 million. The market valuation of shares quoted on the New York stock exchange was probably as great as the aggregate of all other share markets in the world together.

Available statistics regarding the turnover of shares during 1941 indicate, almost without exception, that the volume of business was small compared with other periods when quotations were generally rising, e. g. 1937. The most important exceptions were Milan and Budapest in both the second and the third quarters, and Lisbon in the fourth quarter of the year, when turnovers were relatively high; sporadic activity was also noticeable in some other centres. For stock exchanges where no turnover statistics are available, the comments of market journals and other indications generally pointed towards lack of business. Of all the European stock exchanges, the turnover was probably smallest on the official market in Paris, where the rise in the index was greatest. There were times during the year when the list contained little but unsatisfied "bid" prices against which there were no offers. A market report commenting on this state of affairs said that the bourse was degenerating into an institution for the registration of nominal quotations for deals which did not take place.

The movement of the indexes is naturally affected by the turnover when, as is usually the case, the last quotation of a share (which may have remained unquoted for a long time) is taken in constructing the current index, which thus does not fully reflect the rise. As an example, the two indexes published by the National Bank of Bohemia and Moravia for Prague may be indicated: over the two years to the end of 1941 the index for ten active shares rose by half as much again as the general index covering all share quotations. For the graph, the active index has been taken as more truly reflecting market conditions, although comparison with more comprehensive and slowly moving indexes for some other markets may make the rise in Prague appear relatively too great. Indeed, no index can adequately represent the level of a market where quotations are disjointed and irregular and wide movements take place with little or no dealing.

A further difficulty in the way of international comparison is that in each country various classes of shares have fared differently; industrials, it is true, have been in favour nearly everywhere, but shipping shares in Norway (and other northern countries), oil shares in Roumania, colonials in Holland, etc. were of particular importance. Further, although armament industries are working to capacity, many purchasers have turned their attention rather to those shares which may be expected to benefit also from peace and reconstruction (e. g. in France the group "construction materials" rose to eight times the level of 1939). Bank and insurance shares, on the other hand, have fallen behind; "money shares" of this nature have no "Sachwert" value and profits are restricted by the effects of cheap-money policy on interest margins. How far the rise of the general indexes in the graphs represents the true position depends to a large extent on the weighting of the various classes of shares included.

As share markets deal in previously existing wealth, and fluctuations of quotations do not directly affect the price level of commodities or cause shortages, "control" in the usual sense of price control is not called for. But, as undue increases of quotations have undesirable psychological and other effects, the problem of stock exchange control has recently been posed with actuality.

Stock exchange control is extremely complicated and difficult, since it is almost impossible to establish a measuring rod to show what the market valuation of shares should be. Nominal capital values are no real guide. Dividends (which may be regarded as interest plus a risk premium) give only an inadequate indication; and dividends will fluctuate with corresponding and perfectly legitimate fluctuations of share valuations. Moreover, only part (perhaps a small part) of profits may be distributed as dividends and the balance of profits "ploughed back" into the business. The amounts thus utilised for internal financing have been of great importance in Germany in recent years, as also in the United States and in other countries where large "concerns" have been built up. Of particular importance, from a market point of view, are the amounts written off factories and plant in periods of depression — for they may regain their value in the upswing. Thus no single standard can easily be applied; account must be taken of such factors as interest rates and their trend, taxation and business conditions — including the prospect of future dividends — as well as an estimate of the real value of the assets which the security represents.

As direct control involves so many complexities, reliance had, until recently, been largely placed upon indirect measures to dampen stock exchange enthusiasm, i. e. upon measures whose primary objective was the production of revenue for the budget or the absorption of purchasing power, etc. Many examples might be given: the compression of profits through price control, the increase of direct taxation, the limitation of dividends, etc. In 1941 the profits tax on companies in Holland was replaced by a 15 per cent. dividend tax on shareholders, the dividend tax in Italy was doubled, from 10 to 20 per cent., and the coupon tax in France was also increased.

But, of all measures for the indirect control of share quotations, the limitation of dividends was most to the fore in 1941. New measures were taken in Germany and adopted with various modifications in a number of European countries.

The new German decree of 12th June 1941 maintains the general limit of 6 per cent. on dividends for the duration of the war and imposes a heavy tax on any higher distribution. Profits available for dividends in excess of those paid must be invested by the company, as trustee for the shareholders, in Reich Treasury certificates and only released at a time to be fixed by the Minister for National Economy. The new tax equals one-half of the actual amount paid out as excess dividend up to 7 per cent., is equal to the excess dividend up to 8 per cent., and increases geometrically above this figure. The tax is levied on the company and not on the shareholder — it is thus not a "coupon tax" such as is in force in some other countries. The tax falls very heavily on under-capitalised companies which pay a high nominal dividend (based on assets of greater value than the nominal capital).

To meet this situation the same decree gives under-capitalised companies the right to an adjustment of capital by drawing upon reserves. Nominal capital may be increased from open reserves by the amount by which these reserves exceeded 10 per cent. of the nominal capital for the 1938 balance sheet and from undisclosed reserves to an extent which may not increase the nominal capital above the valuation put upon the company's assets for the corporation-tax return of 1938 (thus excluding a rise of values due to the war). Up to March 1942, 610 companies had increased their aggregate capital from RM 3,315 million to RM 5,213 million by drawing on open and hidden reserves, the increase being on an average by 57 per cent.

Attempts at direct control before 1941 have usually been of a technical market nature and have met with varying degrees of success. Forward markets have nearly everywhere been abolished and dealings put on a cash basis, and in many cases business has been made more expensive (by the direction of all orders on to the bourse, the increase of brokers' commissions and the imposition of stamp duties on share purchases, etc.). Measures such as the fixing of maximum or minimum prices for individual shares, of maximum price rises on a single day or of overall maximum quotations, as well as the prohibition of the publication of unsatisfied "bid" prices, have generally led to the drying-up of business on the stock exchange. Indeed, one of the probable results of direct control is that dealings may be forced outside the official market, and unregulated and, more or less, illegal black markets may spring up.

The following notes give a brief indication of some of the measures introduced in various markets for the control of share quotations during 1941 and early in 1942, omitting the numerous official and unofficial warnings against speculation issued in many countries. The measures taken, which apply particularly to Continental Europe where the boom has been most pronounced, may be classed under a few main heads.

1. Administrative market measures. To assure effective control one of the first steps must be to bring all dealing within the scope of the provisions imposed, i. e. generally on to the official market. In Berlin this "Börsentotalität" was decreed from 1st November 1941, thus putting a stop to the considerable offsetting of customers' purchases and sales previously done by the banks. Similar measures have been taken in Prague, Brussels and on other markets.

In Paris, when operations of the official market dwindled to zero, business on the "free" market (i. e. from office to office and in small cafés round the bourse) was lively at prices 10–25 per cent. above official quotations. This free market was permitted so long as deals were registered with an official broker, a bank or notary. At the end of the year the free market was put under control: direct cessions of shares now require preliminary registration by an official broker, who must, with certain exceptions, refuse the deal if the price is not between the highest and lowest of the three last official quotations. A thorough reorganisation of stock exchange dealing has also been undertaken in certain countries, e. g. France and Hungary.

2. Technical market measures. These include a number of modifications in dealing, etc., intended to tighten up control. In Budapest daily settlements were introduced in 1941 and the units for dealing were raised, e. g. from 10 to 100 shares (to shut out the small speculator). In Italy, one of the few countries where forward deals are still permitted, the legally-required cover was raised by the Finance Minister in June 1941 from 25 to 50 per cent.; but a reduction to the original level was made in August. In the early months of 1942, margins for forward dealing were also raised in Japan, to check the speculative rise of share values. The rationing of purchases was introduced in France from time to time during 1941 and quotations were allowed only for those shares for which the buying orders could be met to at least 25 per cent.; buying orders which met with no offer had to be repeated at the same price.

The publication of unsatisfied "bid" prices has been forbidden in a number of countries, while in Paris and elsewhere single daily prices are fixed. The limitation of fluctuations which might take place on one day was in force in several markets in 1941, particularly Paris, Budapest and Prague. Minimum prices for shares have been in force for a short time in some markets (generally on reopening after a critical period) but do not appear to have been so successful as on government bond markets.

Maximum quotations, or "stop prices", for certain leading shares were introduced for the first time in Berlin on 1st April 1942 and purchases were rationed when necessary. From 12th May 1942, prices on that day were regarded as "guiding quotations" (Richtkurse), thus introducing a sort of general price stop of a flexible nature; brokers no longer automatically raise share prices to bring about equilibrium between supply and demand, price increases being permitted only after consultation with the quotation commissioners. Early in June 1942, somewhat similar measures were introduced in Brussels.

More comprehensive methods of control have been adopted in Vienna and Oslo. In Vienna downward movements of shares were freely allowed but from July 1941 brokers were obliged to justify to the managers of the bourse every quotation of Ostmark shares which showed a rise above the previous marking. The decision of the managers took account only of the position of the company concerned and disallowed rises due merely to the technical market position, leaving shares unquoted when necessary. In Oslo the price control office issued regulations in August 1941 subjecting all transfers of shares (and bonds) to approval by a control committee.

3. Official (or semi-official) purchases and sales of shares to regulate the market have been made in a few countries. When the Tokio bourse fell in 1940 a Joint Financing Syndicate was formed, with official participation, to check the decline; early in 1941 its capital was raised from Yen 20 million to Yen 50 million, to increase its possibility of action. With the outbreak of war in the Pacific, quotations rose abruptly and the syndicate was in a position to sell at a profit.

In Berlin, on the occasion of a sharp decline of the share market in March 1941, the Reichsbank and the issuing houses entered the market to restore orderly dealing. Later, in September-October, when the market was again falling, the Seehandlung (the Prussian State Bank) accentuated the downward movement with its sales. This bank sold from the portfolio of shares which it held in trusteeship for the Reich (received in payment of the tax on Jews in November 1938) and from shares received from other sources in 1941.

4. Taxation on various stock exchange transactions makes purchases more expensive and discourages dealing generally. There are numerous examples of such measures in 1941: in France, Belgium and Finland previously existing dealing taxes were raised. In Italy a transfer supertax was introduced in September 1941 at the rate of 4 per cent. of the sale price; in January 1942 this supertax was changed to 5 per cent. of the difference between the sale price and the nominal value of the shares.

Capital-gains taxes directed particularly against speculation on the stock exchanges have been introduced in France, Italy and Japan. The French tax was imposed from March 1941 and was originally at the rate of 33 per cent. on the increment (exceeding 5 per cent.) resulting from the sale of shares within one year of purchase; in July 1941 the rate was reduced to 20 per cent. and in March 1942 the period for resale was cut down to three months. The Italian tax dates from July 1941 and originally ranged from 10 per cent., if the increment between the buying price (or the price at the end of September 1940, if the shares were bought prior to October 1940) and the selling price did not exceed 10 per cent., to 50 per cent., if the increment exceeded 40 per cent., except for the shares of real estate companies not quoted on the stock exchanges, to which a flat 60 per cent. tax applies on the increment between the share value in 1938 and the selling price. In September the rate of tax was modified to a flat 20 per cent. In Japan also the sharp increase of quotations after the outbreak of war in the Pacific led to the imposition of severe taxes on stock exchange profits (ranging from 25 per cent. of profits up to Yen 100,000, to 50 per cent. above Yen 300,000).

5. Credit measures. Nowhere have official interest rates been raised as a check to speculation, but in several countries the banks have been prohibited from making advances against securities for the purchase of shares on the stock exchange and in some cases marketable shares may not be used as collateral for any bank loan. Although rates have not been raised, the effects on the market valuation of shares may have been one of the reasons against the further accentuation of the cheap money policy in certain countries.

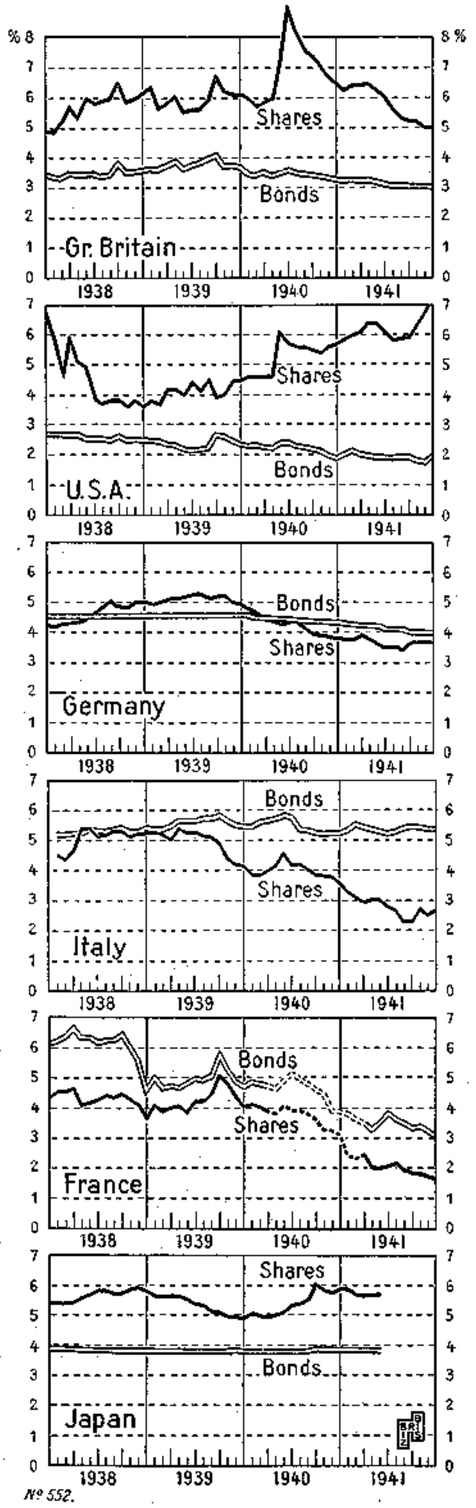
6. Registration of shares. Share certificates in bearer form have always been very popular in Continental Europe, on account of their anonymity and facility of transfer. In France, since March 1941, shares sold on the stock exchange may only be delivered in registered form, or deposited with a bank or broker (and a security deposit and clearing house was set up chiefly for this purpose later in the year). An Italian law called for the transformation of all bearer shares into registered form by June 1942; dividends may in future be paid only on registered shares. In Roumania a decree of March 1941 ordered the transformation of all bearer shares into registered form within one month, after which period shares not deposited for exchange would become the property of the state; in April the time allowed was increased to three months and in June to five months (to 1st September).

7. The declaration of all shares purchased since the war (in excess of RM 100,000) and not resold before 15th March 1942 was decreed in Germany, the declaration to be made to the Reichsbank on the basis of market prices on 31st December 1941. The declarations, which covered shares bought by Germans on the Amsterdam market as well as on German markets (including Vienna and Prague), were officially stated to amount to less than 5 per cent. of all marketable shares; unofficially the amount declared was estimated at a nominal value of RM 850–1,000 million, which constitutes a considerable proportion of the floating material for dealings. By a decree issued in June 1942, owners of declared share holdings may be called, by individual summons, to sell their shares to the Reichsbank at the price quoted on 31st December 1941. The seller will receive the proceeds in the form of interest-bearing Treasury certificates, to be retained on deposit at the Reichsbank and blocked. The shares received by the Reichsbank are to be used to regulate prices on the stock exchange. The decree of June 1942 had the immediate effect of "freezing" all declared holdings of shares and still further reducing the turnover on the market.

Share quotations on continental European bourses generally reached their highest point in September 1941. In that month the German Minister for National Economy announced that "decisive measures" would be taken, and the consequent setback in Berlin directly affected Vienna, Prague and Amsterdam and had indirect effect elsewhere. Although announced in September, the authorisation to call for a declaration of share purchases was not given by decree until December, details of the share purchase declaration were not published until March 1942, and the decree requiring sales of the declared securities was not promulgated until June 1942. The market was thus kept in a continuous state of uncertainty, as, indeed, it was during the first six months of 1941 in anticipation of the new dividend limitation decree. Uncertainty of this kind has proved itself one of the most effective checks on market enthusiasm.

The movement of share quotations, especially where dividend limitation is in force, has naturally had its influence on share yields and their relation to bond yields. Normally, of course, share yields are one or two per cent.

Yields of Shares and Government Bonds,
in percentages.



above the yields from government bonds, the difference being mainly due to the profit risk inherent in private enterprise; this is absent in the case of government issues, which, however, share the money risk inherent in all fixed money claims. Regular calculations of representative share yields are available for very few markets and their computation is open to certain criticism. It is relatively easy to calculate the yield of a government bond; the interest rate is known and does not vary, the date of redemption is given and the risk of default on internal bonds is so small as to be negligible. But dividends on shares do vary; and to calculate a yield it is necessary to look back (at the last dividend) while the share quotation itself is looking forward (to coming dividends).

In a boom, therefore, (with quotations and dividends rising) the calculated yield may be too low, and on the down tack also quotations tend to anticipate dividends and calculated yields may be too high (1). Further, share and bond yields are calculated gross, i. e. before deduction of direct taxation on coupons; net yields would be lower, in some cases much lower, than the gross. Nevertheless, the calculation of average share yields and their comparison with bond yields have a certain value as an indication of the general position of the markets. With that object the accompanying graphs have been prepared for markets where material is available.

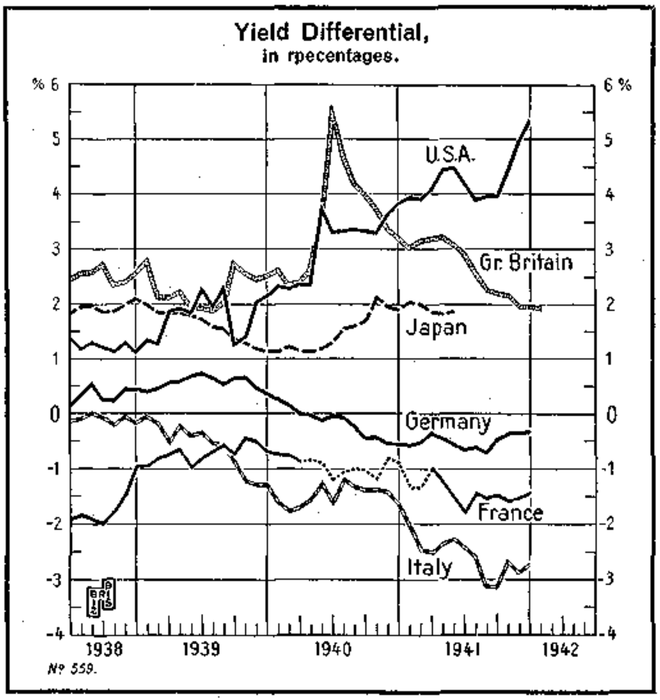
In the United States, in England and Japan average share yields are 5 per cent. or more, and well above

(1) A striking example is given by the apparent rise of share yields in England from November to December 1941, due to the fall of quotations of rubber, tin and other companies operating in the Far East. Judged by past dividends, the yields on these shares were high in December 1941 and they rose further in the following months — but on the basis of probable dividends in the future the yields were obviously of a speculative nature.

the yields of government bonds. In the United States, indeed, the share yield is the highest and the bond yield the lowest of anywhere in the world, there being a spread of 5 per cent. in December 1941(1), a very unusual situation (and a reversal of the position in September 1929, when bond yields were nearly 5 per cent. and share yields fell momentarily below 3 per cent.).

For Germany, the bond yield shown includes local government as well as Reich securities, the yield for the latter being slightly lower (new issues are made at 3½ per cent.). In March 1941 the President of the Reichsbank characterised the yield relationship as unsound; and the share yield rose towards the end of the year to a little under 4 per cent., approximately the same level as the average yield on all Reich long-term securities outstanding. In Italy, share and bond yields parted company in 1939 as a result of the rise of share quotations; while the government bond yield remains above 5 per cent., the average yield on shares fell below 3 per cent. in the second half of 1941.

Indeed, in Continental Europe as a whole, the normal relationship of bond and share yields is now rarely to be found. In the majority of countries share yields are below, in some cases far below, the already relatively low yields of government bonds. In France, indeed, share yields have been below bond yields for so many years that this has become the "normal" relationship; only in one month of 1932 did the share yield touch 5 per cent. but yields of under 2 per cent. at the end of 1941 were the lowest since the war of 1914–18. More fragmentary material regarding other continental European markets, however, shows that an average yield of about 2 per cent. for shares is not unusual at the present time; for all shares quoted in Oslo the average yield is below 2½ per cent., for all shares in Brussels about 2 per cent., for all shares in Prague below 2 per cent. and for leading shares in Budapest 1½–2 per cent.



Note: For each of the six countries having share and government bond yields available, the simple absolute difference between the yields is shown. Above zero indicates that the share yield is higher than the yield on government bonds, while below zero (—) the bond yield is higher.

(1) The average yield of all shares quoted at the end of 1941, including those which paid no dividend, was 7.6 per cent.; dividend-payers alone averaged 9.3 per cent.

The divorce of share quotations from the trend of current earning power and dividends is strikingly shown by statistics published by the National Bank of Belgium and summarised below.

Brussels Stock Exchange.

Period	Shares quoted (1)		Net profits (2)	Gross dividends (2)
	Market valuation	Nominal value		
	in milliards of B. francs			
1939	33.1	22.5	4.4	4.0
1940	65.1	18.9	3.6	3.0
1941	109.5	18.4	3.3	2.4

(1) As at the beginning of January in the following year.
(2) The statistics cover a large sample of companies (1939: 7659, 1940: 6831 and 1941: 7067) and apply to the whole of the calendar year.

During the year to January 1941, the nominal capital of shares quoted decreased by 16 per cent., while the market value rose by 96 per cent.; again, during the year to January 1942, the nominal capital decreased by 3 per cent. while the market value rose by 68 per cent. During the whole of this period the aggregates of net profits earned and of dividends declared were declining.

In some countries means have been found to increase payments to shareholders in spite of the limitation of dividends. In Italy, for example, the issue of bonus shares had more and more taken on the character of super-dividends until in December 1940 a prohibitive tax was placed upon their creation. In order to facilitate the raising of funds for the war economy, however, a change was made in March 1941 and the issue of bonus shares was permitted in so far as the companies concerned had reduced their capital during the period 1928–39. But, even where dividend limitation is strictly enforced, purchasers often tend to pay less attention to yields than to the "intrinsic value" of shares and to regard a company's policy as to amortisation of factories and plant as of more significance than the dividends it actually declares.

The history of the stock exchanges in 1941, especially those of Continental Europe, is both interesting and instructive. In a number of countries quotations are very high and are out of relation to current yields, and, in some cases, production (and profits) are falling off owing to shortages of raw materials and fuel. Undoubtedly the attraction of shares as representing "real values" is strong (particularly in countries which in the past have been through the bitter experience of inflation) and reflects not present earning power so much as the real or imaginary risk of holding money claims.

There is a certain danger that, after the war, if not before, the withdrawal of the surplus liquid funds of companies invested temporarily in the share markets may bring a violent slump. But the danger of losses is confined to the holders of shares. As dealings are for cash only, shares are firmly held and there is very little or no speculation on credit. Indeed, bank lending against such securities is very small or non-existent. There would thus appear to be little danger to the credit structure as a whole from a fall of the share markets, even if severe.

Experience gained during the year has shown the difficulty of maintaining a regular functioning market, while influencing the trend of quotations by direct measures of control. But, although many markets are very thin, efforts have been made to keep the bourses open and working. Not only do they serve a necessary economic purpose, but a well-functioning stock exchange, or bond market at least, is an essential adjunct to the governments' war financing.

The boom on the bourses of Continental Europe is merely a symptom that excess purchasing power exists and is active; the annual report of the National Bank of Hungary for 1941 states: "There can be no doubt that the barriers placed in the way of the formation of stock exchange quotations do not, in themselves, remove the want of equilibrium which is behind these rises". Indeed it is only by tackling the root of the evil and not the symptoms that a more normal quotation-yield relationship may be attained.

VI. CENTRAL BANKING DEVELOPMENTS.

The most interesting recent development of the laws governing central banks is the far-reaching reorganisation of the statutes of the Bank of Japan: and two new Japanese banks arising from war conditions have been established. In Europe territorial changes have led to the liquidation of one central bank and the creation of three new ones. Modifications of the statutes of existing central banks have largely taken a form familiar in recent years — the adaptation of note-cover requirements to the increased circulations (instead of adapting the circulation to the legal requirements, as used to be the case in the old days). Note circulations have, indeed, continued to rise rapidly and, although the rate of increase differs widely from country to country, it nearly everywhere exceeds the rate of increase of bank deposits.

The Nippon Ginko, or Bank of Japan, was founded in the 15th year of Meiji (1882) and during the sixty years until 1942 (when its term of business was to expire) there had been no considerable change in its statutes. But in March 1942 new legislation came into force which fundamentally altered the whole character of the bank, changing it from a semi-official institution into an official state body (although still with private shareholders).

Under the new statutes the bank assumes all tasks connected with the note circulation, the regulation of money and the maintenance of the credit system in accordance with state policy, in order to ensure utilisation of the country's full economic potential. A special paragraph stresses the obligation of the bank to render national services. The president and vice-president of the bank are appointed by the government with imperial agreement (previously the post of governor was an imperial nomination); directors are appointed by the Finance Minister from a list recommended by the president of the bank (previously by the shareholders). The bank's seat is in Tokio: its capital amounts to Yen 100 million (previously Yen 60 million), the government holding Yen 5½ million. Deposits from foreigners are not permitted.

The bank's range of activities is greatly extended beyond what it used to be and, indeed, far exceeds what is usual for a central bank. In addition to ordinary credit operations, the bank may grant advances to the government without security, subscribe to government loans or take them over directly; it may provide direct financing for Japanese industry and make loans against securities or goods; it may carry out all operations on the open market, and, in case of absolute necessity, undertake foreign exchange business in the widest sense, including clearing (previously foreign exchange operations were the exclusive province of the Yokohama Specie Bank). Business in the interests of the bank, but outside the limitations of the statutes, may be done upon the authorisation of the Finance Minister; inter alia, the provision of capital for foreign institutions is specifically mentioned; the Finance Minister may also issue decrees permitting the commercial banks to collaborate with the Bank of Japan and he is thus given the possibility of intervention in the entire banking and credit system of the country.

The transitory modification of the note-issue regulations in 1941 (for the duration of the war with China) has been made permanent. The note-issue regulations had previously been on the lines of those of the Bank of England, with a fixed fiduciary issue plus the circulation fully covered by gold (and a small amount of silver). In Japan, however, there were always "excess issues" in recent years above the fiduciary limit, against which excess a tax was payable. This fiduciary limit was raised from Yen 120 million to Yen 1,000 million in 1932, and, by further steps, to Yen 2,200 million in 1939. In March 1941, when excess issues were Yen 1,200 million, the previous distinction between fiduciary and gold cover was abolished and a new overall limit of Yen 4,700 million set by the Finance Minister. (Fairly extensive modifications were made in the bank's weekly returns from April 1941; several items were changed or combined, the gold holding, for example, being no longer shown separately but as part of a comprehensive reserve item).

Similar amendments were made in the laws governing the Banks of Chosen (Korea) and Taiwan (Formosa); and these two colonial banks were permitted to hold balances with the Bank of Japan as primary cover (instead of notes of the Bank of Japan as previously).

The limit of note circulation fixed for the Bank of Japan was exceeded by the end of November 1941 and a new limit of Yen 6,000 million fixed from 1st April 1942. Under the new law of 1942 the bank may issue notes in excess of this limit, upon authorisation by the Minister, without paying the special tax. A cover equivalent to the notes issued must be maintained, in the form of commercial bills, bankers' acceptances and other bills, government securities, state debentures and other debt debentures authorised by the Finance Minister, foreign exchange, gold and silver in bars and in coin. The bank must announce publicly the amount of notes issued and must submit yearly accounts to the Finance Minister. It must pay to the shareholders other than the government a dividend of not less than 4 per cent. and not more than 5 per cent. (previously a fixed 6 per cent. had been paid); surplus profits, after provision for reserves, go to the government, which, however, pays the dividend, if it is not earned. The shareholders appear to have no other rights than to receive the guaranteed dividend; an annual general meeting is not mentioned in the statutes.

In May 1942 the Bank of Japan assumed new functions as the central financial institution for the East Asiatic economic area. A new law, which came into force on 2nd May, extends the business scope of the bank to all occupied southern areas.

In the early months of 1942, two new banks, with their headquarters in Tokio, were formed; although legally autonomous, they operate, in fact, as institutions affiliated to the Bank of Japan. The law creating the W a r t i m e

Financing Bank came into force on 28th February 1942; the bank has a capital of Yen 300 million, two-thirds being taken up by the government and one-third by the Joint Financing Syndicate and various banks and insurance companies; bonds may be issued up to ten times the paid-up capital. This bank is to undertake wartime financing of a nature outside the functions of other financial institutions. Its funds are to be used for three main purposes: the provision of capital for companies with national aims; the mobilisation of idle plant; and the building-up of stocks for storage. It also aims at the stabilisation of market prices for securities. This bank has been formed essentially to cover Japanese internal credit requirements.

A special bank, the South Seas Development Bank, was created at the same time for the exploitation of the newly-occupied territories. The bank is given complete control of all capital transactions between Japan and the South Seas, so that new investment of Japanese private capital (which was permitted in Manchukuo) is excluded, at least until the situation becomes more clear and stabilised. The capital of the bank, Yen 100 million, is provided entirely by the government from the war budget. The bank may issue bonds up to ten times its capital; these bonds are to be placed as far as possible in the occupied territories, which should thus finance themselves. The business of the bank, to be conducted temporarily in "military notes", is to provide funds for the development of raw material resources and to regulate the money and credit markets in the South Sea territories; local currencies are to be maintained for the future with adjusted rates vis-à-vis the yen. The bank may accept deposits, buy and sell gold and silver, exchange money, buy and sell foreign exchange and transact all similar business: but these transactions may be effected only with banks and similar organisations, and not with the public. The credit business of the bank is to be on the lines of the Industrial Bank and the Mortgage Bank of Japan, principally, if not wholly, in the form of long-term loans to agriculture and to mining and industrial enterprises. The new bank may open branches which will be supervised by the local military authorities: by the end of April branches had been opened at Shonan (Singapore), Manila and Batavia and on the islands of Borneo, Sumatra and Celebes. As a whole the commercial activity of the bank is to be complementary to, and not competitive with, the other banks. Short-term financing will be conducted by existing Japanese or local banks: foreign banks in enemy hands are being liquidated or taken over by the Japanese; neutral and local banks are allowed to remain. (Early in May 1942 the Bank of Taiwan and the Yokohama Specie Bank opened branches in Hong Kong, Manila and Shonan, and the latter bank also in Rangoon; branches in Java were to be opened later.)

In April 1942 a new Bank of Thailand was established with the express object of cooperating in the development of the "co-prosperity sphere": the bank, with a capital of Bahts 20 million provided by the government, will assume control over the Siamese banks and take over the issue of bank-notes hitherto effected by the Ministry of Finance. From 22nd April 1942 the baht was put at parity with the yen and, later, the yen was admitted as cover for the note issue.

In Europe, hostilities between Germany and the U. S. S. R. have led to a number of important developments. In the wake of the German armies, the economic commandos take immediate charge of the entire economy of the occupied territories, including the monetary system, and utilise local resources to enable the troops to live, as far as possible, off the country. These commandos, consisting of army officers and officials, specialists, non-commissioned officers and men, represent in a concentrated military form a comprehensive economic administration. The opening of Reichskreditkassen was described in Chapter V; the Reichskreditkassenscheine supplement and to some extent replace the local currency.

Later came the civil authorities and the setting-up of administrative areas. The district of Bialystok (in the north of the former Polish territory occupied by Russia) was attached to East Prussia in August 1941 and from 15th December 1941 Reichsbank notes replaced roubles and Reichskreditkassenscheine. This district is now "internal" for the purposes of the German exchange regulations; other areas mentioned below remain "devisenausland", i. e. there is no free currency circulation with Germany either for the inhabitants or for the German army there. In August 1941 Galicia was attached to the Governor-Generalship and the Reichskreditkasse at Lemberg became a branch of the Bank of Issue in Poland (Reichskreditkassenscheine and roubles being exchanged for zloty). The part of the Carelian isthmus previously belonging to Finland has been put under Finnish administration; Bessarabia and Bukovina have been reincorporated into Roumania and Transnistria (part of the Ukraine with Odessa as capital) has been put under Roumanian administration (the circulation consisting of Reichskreditkassenscheine and Roumanian currency). Two new administrative areas under direct German command have been created, the Ostland (comprising the former states of Lithuania, Latvia and Estonia as well as White Ruthenia, the area round Minsk,) in the north, and the Ukraine in the south, both in the form of a "Reichskommissariat".

In the Ostland (not to be confused with the Ostmark, or former Austrian territories), the three Baltic central banks (Lietuvos Bankas, Latvijas Banka and the Eesti Pank) reopened, after the German occupation, making use of their Soviet statutes and regulations, under the guidance of a German Commissioner. For the time being the currency consists of roubles and Reichskreditkassenscheine*, and early in March 1942 a Gemeinschaftsbank was created, with its head office in Riga. This bank, for which the German Commissioner acts as guarantor, has power to undertake all general business for the economic reconstruction of the territory; it functions as a mortgage bank, agricultural bank and central office for the savings banks etc., and may issue mortgage and other bonds. The privilege of note issue remains for the present with the Reichskreditkassen, but a new central bank has been planned.

---

* In June 1942 it was reported that roubles had been converted into Reichskassenscheine to the following amounts: in Estonia, about 154 million roubles out of a total of 235 million; in Latvia, about 280 million out of 367 million; and, in Lithuania, about 212 million out of 300 million.

On 5th March 1942 the German Commissioner issued a decree setting up a new Ukraine Central Bank with its seat provisionally at Rovno (in the former eastern Polish province of Volhynia). This bank, with a Reichsbank official in charge, opened for business on 1st June, took over the Reichskreditkassen in its territory as branches and began the exchange of the Reichskreditkassenscheine and roubles in circulation for a new currency, the "carbovanez" (the old name for Ukrainian currency). The new notes are guaranteed, like the circulation of zloty in the Governor-Generalship, by a general mortgage on land. Besides the usual central-bank credit business, the new bank will have charge of the clearings and is empowered to grant credits, within certain limits, to the administrative authorities. The bank's main sphere of business, however, is to be the provision of reconstruction credits (for the purchase of agricultural machinery, for rebuilding and for the extension of communications, etc.). On the opening of the bank, the discount rate was fixed at 3½ per cent. and the lombard rate at 4½ per cent. In March 1942 a decree setting up business banks in the territory was also published.

In the Westmark, consisting principally of territory attached to the Reich after the 1940 campaign, a Gemeinschaftsbank has also been founded: the Landesbank und Girozentrale der Westmark, as it is called, was created by the amalgamation of five existing banks; it has a capital of RM 8 million and its head office is in Saarbrücken. The currency in this area consists of notes of the Reichsbank.

After the occupation and partition of Yugoslavia, the remaining territory was divided into two states, Serbia (under German military administration) and Croatia (an independent state under Italian auspices). By decree of the German military commander, the old National Bank of Yugoslavia was put into liquidation from 29th May 1941; a large part of its assets, part of the stock of unissued notes and the books of the head office had disappeared, while its liabilities on account of notes issued became international (as seven different currencies replaced the old Yugoslav dinar). On the same day the decree establishing the Serbian National Bank with its head office in Belgrade was published and the bank began operations on 3rd June 1941. The new bank is under the direct control of the German Plenipotentiary for Economic Affairs, who appoints the (Serbian) governor and directors, and also a German Commissioner (whose approval is required for all important transactions). It has a capital of S. Dinar 100 million, to be taken up in large part by the state. The opening business of the bank was the exchange of old Yugoslav dinar notes and Reichskreditkassenscheine for new Serbian dinars, the state handing over to the bank debt certificates to the amount of the notes exchanged (plus old giro balances taken over). The bank may buy government bonds up to the amount of its capital and reserves (excluding the debt certificates as above); it may buy Treasury bills and make advances to the state up to maxima to be fixed. The other credit business is that usual to central banks, except for certain modifications due to the agricultural nature of the country. The cover for the note issue may include balances at foreign banks of issue and clearing institutions. The balance sheet and profit and loss account drawn up at the end of the business year (which corresponds to the calendar year) must be published within six months. No weekly or monthly returns have been published.

The Croatian State Bank was set up by a decree of the Chief of the Independent State dated 10th May 1941, its first business being the exchange of old Yugoslav dinar notes and Reichskreditkassenscheine for the new kuna notes of the Croatian Government. The new bank has not yet been given a legal charter or other status and is at present working under the statutes of the old National Bank of Yugoslavia and instructions from the Ministry of Finance. No weekly or monthly returns have been published.

Changes of statutes of existing central banks have generally taken two forms, the authorisation to grant further credits to the government and the adaptation of note-cover requirements to the higher note circulations. In the former class the modifications generally amount to the raising of limits fixed in previous years. For example, the limit fixed for the special advances from the Bank of France to the French Government to cover the costs of the German troops of occupation has been raised according to the conventions as shown in the table (each convention confirmed by decree).

Bank of France.
Special advances
to government to cover
costs of occupation.

Date of convention	Limit in Fr.fcs milliards
1940 August 25th *	50
October 29th	65
December 12th	73
December 30th	85
1941 February 20th	100
April 30th	104
May 10th	108
June 11th	118
September 11th	130
November 27th	142
December 26th	150
1942 March 5th	160
April 30th	169
June 11th	181

* Original advance.

On 6th July 1941 the German military commander in France issued a decree cancelling the earlier decree of 23rd July 1940, which defined the functions of the German Commissioner at the Bank of France; for the future the rôle of the Commissioner has been determined by an arrangement made directly between the two governments.

In the statutes of the central banks newly created in Europe (the latest example being the Serbian National Bank), the regulations are framed in such a way that Reichsmarks may be included in the primary reserves against the note issue. The domination of the Reichsmark in continental European exchanges and the recent practice of many central banks of granting advances against clearing balances have made some modification of the original reserve provision necessary in several of the older banks also. In Roumania the original statutes of 1929 prescribed a reserve of 35 per cent. of the notes in circulation and other sight liabilities, to be held in gold and in foreign exchange "legally and practically convertible into exportable gold", 25 per cent. to be in gold held in the bank's vaults or on freely available deposit abroad. In September 1939 the 25 per cent. gold reserve was retained but the extra cover in foreign exchange, re-defined as "legally convertible into gold", was made optional (each particular case requiring the sanction of the general council of the bank). In December 1941, out of a total gold holding of 162,000 kilogrammes, 12,000 were in the United States and 10,000 under earmark at the Bank of England. In both cases these were blocked; as a consequence a further change of the statutes was made to include "effective claims to gold" in the reserve. In addition, the definition of the optional cover was again modified to comprise foreign exchange "legally expressed (libellé) in gold". By a convention of 19th June 1941, the National Bank granted the government an advance of Lei 12 milliard (which, until June 1942, was booked in the balance sheet under "sundry accounts").

In Bulgaria, gold and foreign exchange convertible in law and practice into exportable gold have been retained, without change of definition, to form the 25 per cent. reserve; but a modification of the statutes in May 1941 adds that "all other foreign exchange, after deduction of liabilities in the same currencies", also serves as cover for the notes in circulation and other sight liabilities. The Governor of the National Bank has explained that the creation of a multilateral clearing in Berlin justified the inclusion of the Reichsmark in the bank's reserves as a free currency. This change raised the calculated reserve from 25.3 per cent. to 33.2 per cent. in the last week of May 1941. Further changes in the statutes were made early in 1942, the most important being the abolition of the limit on the purchase of government paper.

The law of 1937 governing the Nederlandsche Bank was altered in March 1942 when "balances with foreign banks, foreign cheques, bills and other trade paper and Treasury bills payable abroad" were made eligible for the 40 per cent. reserve, previously held in gold only. As the bank's foreign bills and other foreign claims are almost exclusively in Reichsmarks, this currency now ranks equally with gold as cover for the Dutch florin. The effect of this provision was to raise the reserve from under 41 per cent. to over 90 per cent. at the end of March 1942. In Belgium the situation was complicated by the fact that the Reichsmark clearing claims were held by the Bank of Issue, which was financed by an advance from the National Bank. Early in March 1942 this advance had reached an amount equal to about half of the gold holding, while the reserve of gold (and foreign exchange convertible into gold) had, as a result of the rise in the note circulation, fallen near to the legal minimum of 40 per cent. The consideration of gold as reserve had, indeed, become somewhat of a fiction, since less than one-twentieth of one per cent. of the total gold holding was available in Belgium. The knot was cut by the German military commander (for Belgium and Northern France) with a decree of 6th March 1942 suspending the reserve provisions until further notice.

In other countries outside Continental Europe increasing note circulations have also forced changes in cover provisions. The fiduciary circulation of the Bank of England (the amount of notes which may be issued over and above the gold reserves) was raised from £300 million to £580 million on the outbreak of war in September 1939, when the entire gold holding of the bank was transferred to the Exchange Equalisation Account. The fiduciary issue was further raised once in 1940 (June), three times in 1941 (April, August and December) and again in 1942 (April); each increase was by £50 million, so that the total issue permitted (in addition to the negligible gold holding) was £830 million from April 1942 onwards. This limit has ceased to have its original significance: in earlier days, approach to the limit foreshadowed recourse to credit restriction and higher money rates to correct the position; at present, the limit is raised whenever necessary, but the mechanism is retained for its psychological effect, as a recurring reminder that the note circulation is rising.

Note circulations are, indeed, rising everywhere as the following graphs illustrate. The end-of-month note circulation in thirteen European and seven overseas countries has been calculated as an index on the base of the average circulation in the first half of 1939 (equal to 100) and the monthly figures plotted as graphs. Without exception the circulations have risen, the increase up to the end of 1941 ranging in importance from 24 per cent. in the Argentine to 371 per cent. in Bulgaria. The accompanying table summarises the data on which the graphs are based (and includes a column giving the position at the end of 1941 on a 1929 basis, which may be compared with the corresponding graph in the eleventh Annual Report, page 180).

Only the central banks' note circulations are shown in the graphs (except the United States, for which the "money in circulation" has been taken), but it is considered that these curves give a reasonably correct indication of the total circulation of currency in the countries. Coin has generally increased roughly in the same proportions as the note issues. In a few countries new central-bank notes have been issued to supplement or replace coin (e. g. in Switzerland); in others coin has replaced small central-bank notes previously issued (e. g. Hungary); elsewhere small government notes have been issued to supplement or replace the coinage (e. g. Rentenbank notes in Germany and silver certificates in Holland): but allowance for these changes

Index of note circulations.

Position of former index at end of 1941 On basis of end 1929 = 100	Country	Position of new index at end of 1939	1940	1941
		On basis of Jan.–June 1939 = 100		
373	Bulgaria	148	228	471
538	Finland	184	253	334
457	Roumania	130	172	258
364	Japan	163	206	256
191	Egypt	129	182	247
379	Germany	147	174	237
396	Hungary	113	161	230
394	France	127	185	226
241	Canada	122	169	223
361	Belgium	127	158	219
201	Australia	135	156	215
219	Portugal	121	138	213
245	Holland	112	160	205
229	Denmark	139	172	195
299	Sweden	139	145	166
244	United States	111	127	163
289	South Africa	108	131	161
203	United Kingdom	112	126	154
234	Switzerland	119	132	136
144	Argentine	102	109	124

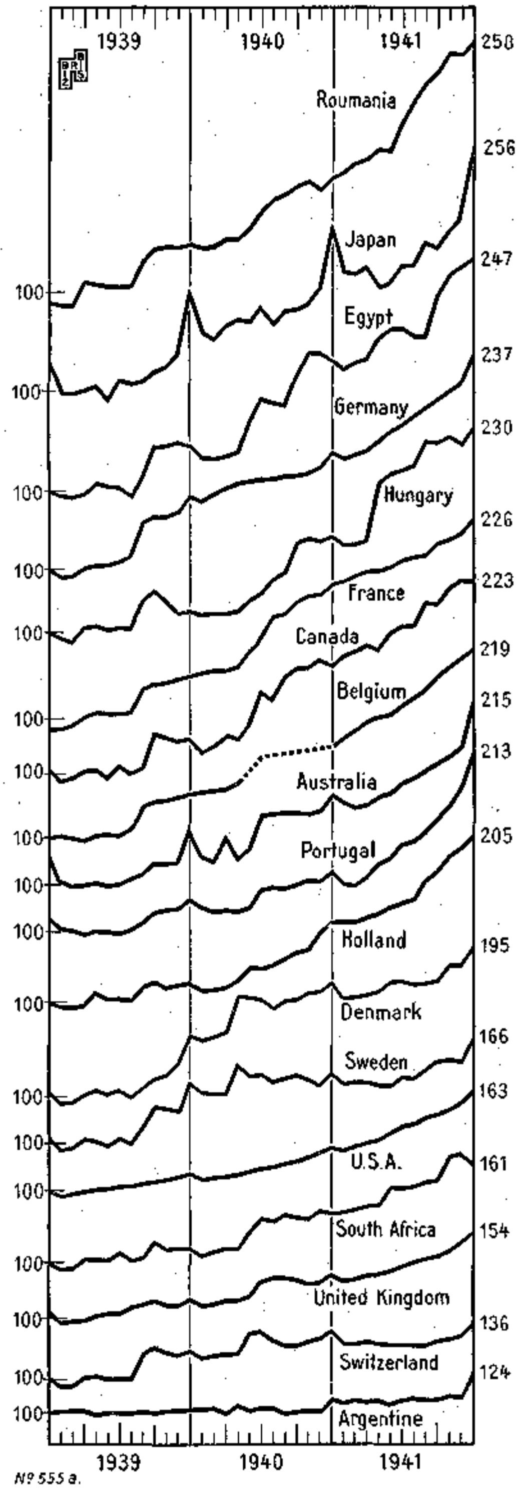
would not appreciably alter the picture.

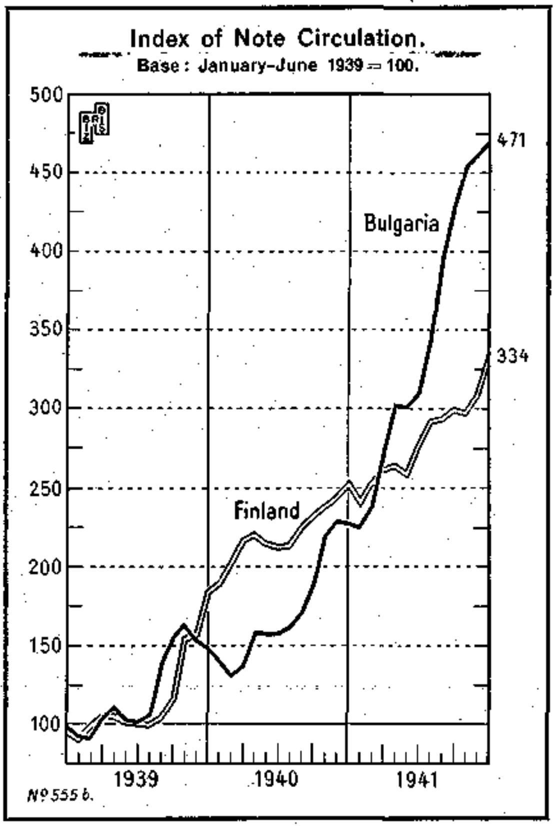
Already before the war, note circulations had risen generally throughout the world. A number of reasons for this have been given in earlier Annual Reports: "Higher amounts paid as wages and spent on consumption goods, larger amounts carried as cash by the individual or held as reserves by commercial banks and other institutions, and an increase of hoarding, affected perhaps by the low rates paid on deposits, are among the most important general factors." And, as the war approached, the direct or indirect financing of the governments by the central banks and the demands for liquidity by the public both increased.

In wartime several further reasons for the expansion of the note circulations must be added: the increase of pay rolls as a result of higher wages in the armament industries, prolonged working hours and the mobilisation of fresh labour forces require more currency, while soldiers are usually paid in notes, and family allowances give rise to many small payments; cash holdings of individual households have probably further increased and the velocity of circulation is generally slowed down in trade and business circles by transport difficulties and the curtailment of banking facilities (owing to shortage of personnel and other causes).

In some countries there are special factors. Between mid-August 1939 and the end of December 1941, the note circulation of the **Reichsbank** rose from RM 8.7 milliard to RM 19.3 milliard; in the

Index of Note Circulation.
Base: January-June 1939 = 100.





same period new territories, with a population of 13½ million, were incorporated into the Reich, accounting, it is estimated, for about RM 2 milliard of the increase; in addition, there are more than 2 million foreign workers in Germany, Reichsmark means of payment may be hoarded in some of the occupied areas, although it is difficult to estimate to what extent; in both Belgium and Serbia the German military commanders have issued decrees against the hoarding of money, particularly in safe deposit at banks (on the lines of provisions already in force in Germany).

Other countries besides Germany have issued notes in newly-attached territories during the war. The National Bank of Hungary had a circulation of P. 1,984 million at the end of 1941, of which P. 215 million owed its origin to the withdrawal of Roumanian currency and P. 191 million replaced old Yugoslav currency. The National Bank of Bulgaria has issued its own notes against the withdrawal of Roumanian, Yugoslav and Greek currencies to an amount not clearly shown in the weekly return (but reliably estimated at "not much more than Leva 1 milliard" out of a total circulation of Leva 13½ milliard at the end of 1941). Roumanian currency exchanged in these countries has been deducted from the circulation shown by the National Bank of Roumania but this bank has issued its own currency against roubles in the reoccupied provinces and in Transnistria.

The rise in the note circulation of the Bank of France in 1941 was principally due to the increase of special advances to cover the costs of occupation, but in certain other continental European countries the dominant influence was the financing of the clearings by or through the medium of central-bank credit.

In England, in addition to other factors, evasion of taxation on commercial operations and an increase of "black market" dealings have been mentioned as partly responsible for the recent rise of the note circulation; and similar reasons doubtless hold good for a number of continental European countries also.

In all countries the increase of the note circulation is in some measure due to the imperfections of the "circuit" which takes money spent by the government round the monetary and banking system and back to the government as savings invested directly in Treasury securities or through bank deposits and in other ways. The Governor of the Banca d'Italia mentioned this subject at the general meeting of the bank on 30th March 1942. A summary of what he said is as follows: The limitation of consumption, price control and the stop upon real investments were, with taxation, the means employed by the governments of all countries to direct surplus purchasing power to the public coffers. In no country, however, had the so-called capital circuit become absolutely watertight, partly because the means could not be employed with complete consistency, partly for psychological reasons, partly because the factors governing the circuit were not all perfectly known and calculable with mathematical accuracy, and partly because the steady expansion of public expenditure tended to increase the time lag between outlay and reabsorption of funds. Owing to this increasing time lag, it was inevitable that part of the government expenditure should be financed by recourse to the central bank — hence the continued rapid rate of expansion of the note circulation in all countries in the second year of the war.

All measures taken to check inflation or to absorb excess purchasing power are, of course, aimed at the total volume of means of payment in effective circulation but it is interesting to mention a number of direct steps taken in certain countries against the expansion of the note issue particularly. A decree of October 1940 in France made payment by cheque or transfer obligatory for all payments exceeding Fr.fcs 3,000 except agricultural payments at the fairs and markets; a similar measure was taken in Greece in December 1941 for payments exceeding Dr. 30,000. How far such measures are likely to reduce the note circulation it is difficult to say; payments by cheque are said to have risen considerably in France since the recent decree but the issue, nevertheless, grows apace — particularly of those Fr.fcs 5,000 notes which, for over a year now, have had their circulation legally restricted. The Minister of Finance has recently imposed a system of fines for the violation of the decree of October 1940.

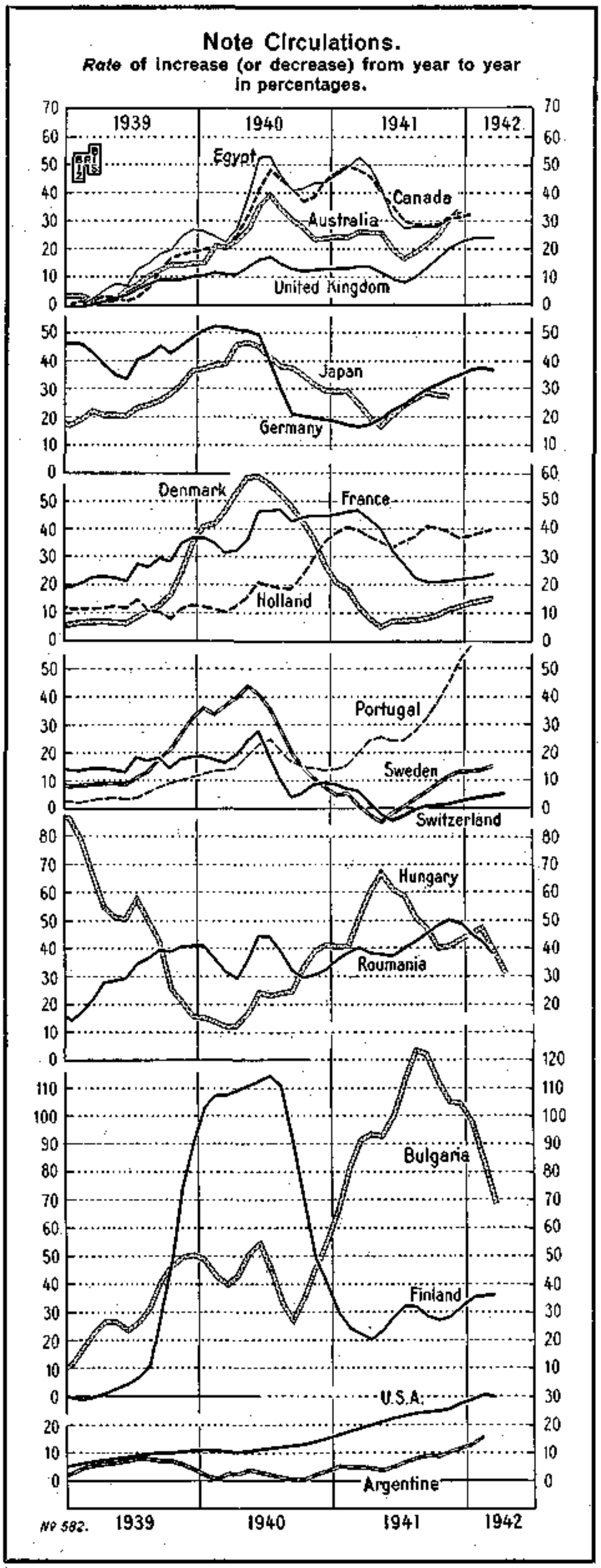
Bank of France — Note circulation.

Denomination of notes	1938	1939	1940	1941	*Percentage increase 1938–1941*	*Percentage increase 1940–1941*
	At end of year in milliards of Fr.fcs					
5,000	2	12	32	47	*+ 2,099*	*+ 44*
1,000	62	83	111	135	*+ 115*	*+ 21*
500	12	16	20	27	*+ 118*	*+ 31*
100	28	33	46	48	*+ 69*	*+ 5*
Others*	4	5	9	10	*+ 179*	*+ 14*
Total	109	149	218	266	*+ 144*	*+ 22*

* 5, 10, 20 and 50 francs.

Several countries have adopted procedure somewhat similar to the "delivery bill" technique of 1938–39 in Germany, i. e. payment of government contracts partly by means of short or medium-term Treasury paper: Belgium is one of the countries which have most recently adopted this practice (February 1942), while payments from the clearing account, hitherto made in cash, are also to be made in Treasury bills.

Of a fundamentally different character is the new issue of Treasury certificates in Bulgaria. By decree of 9th February 1942 the Treasury issues 3 per cent. one and two-year certificates in cover of its extraordinary expenditure:



these certificates may be issued for small amounts (e.g. Leva 1,000 and 5,000, for which denominations bank-notes exist) and also up to Leva 100,000, and may be cashed at any time at the National Bank; they are designed to circulate as interest-bearing bank-notes and have printed on them their value (with interest) on the 5th, 15th and 25th of each month they have to run. The *first tranche* of these Treasury certificates was for Leva 1,000 million (Leva 750 million at one year and Leva 250 million at two years maturity). These Treasury certificates are intended to take the place of part of the note issue (Leva 13,500 million at the end of 1941) but obviously do not reduce the total circulating media. In April 1942 two new decrees were issued with further ideas to check the expansion of the note issue: cash payments between banks are prohibited and claims have to be settled by way of clearing; all payments exceeding Leva 100,000 by commercial enterprises (with some exceptions) may be settled only by cheque; orders by the government and local authorities will be settled in the clearing if they exceed Leva 30,000.

The series of graphs on this page have been designed to show variations in the annual *rate* of increase of the note circulations.

The note circulation at the end of each month has been compared with the same month of the previous year and the result shown as a percentage increase (or decrease). A three-month moving average has been taken to smooth out accidental variations due to the date of the returns (not always the last day of the month). For convenience of presentation several separate graphs have been made.

Space does not permit a detailed commentary on all the curves but some general remarks are called for. In many cases the highest rate of increase of note circulations was reached near the middle of 1940, from which point there was a decline continuing into 1941; and at the end of 1941 most curves are pointing upwards again. The similarity of the lines for Canada and Egypt is remarkable and is reflected also in the curve for Australia and, more weakly, for England (where, however, there is a strong upturn in the second half of 1941). In Germany the rate of increase declined sharply from the middle of 1940, when a large part of the army was in occupied enemy territory and was being paid by means of Reichskreditkassenscheine. For France the slowing-up began in the spring of 1941, when a larger part of the occupation costs was financed directly by the Treasury (see graph in Chapter V). Of the three continental neutrals, Sweden and Switzerland show some similarity; in both countries the note issues declined near the middle of 1941 (when the "rate of increase" fell below zero): but in Portugal there was an acceleration of the increase in 1941. In 1940, until the Peace of Moscow ending the first Russian war, the rate of increase in Finland was over 100 per cent. per annum: i. e. at this rate the note circulation would have doubled in a year; in 1941 the rate of expansion fell to more moderate proportions. In Bulgaria, however, the acceleration at the end of 1940 extended into 1941 and, in spite of some check, was still at the rate of 100 per cent. at the end of the year.

At the end of 1941 the note circulation had practically ceased to grow in Switzerland; in the Argentine, Sweden and Denmark the rate of increase was slightly over 10 per cent. per annum; it was 20–25 per cent. in England, the United States and France; 30 per cent. in Finland; 35 per cent. in Germany and Holland; 40–50 per cent. in Hungary, Roumania and Portugal and 100 per cent. in Bulgaria.

But bank-notes are only part of the total circulating media and, to obtain a more comprehensive picture of developments, it is necessary to consider the growth of bank deposits, particularly those at the big commercial banks. As monthly statistics of bank deposits are not now available for some countries, the following table has been based on figures in the end-of-year balance sheets of the big banks.

The annual increases of the note issue may differ slightly from those shown in the graph, since the following table gives end-of-year percentages only for comparison with the similar figures for bank deposits.

The first two sections of the table show that, with minor exceptions (of which Denmark is the most interesting), note circulations in 1941 rose

Comparative evolution of note circulations and deposits with the big commercial banks.*

End of year	United States	United Kingdom	Germany	Italy	France	Holland	Denmark	Finland	Sweden	Switzerland
Note circulations — percentage increases on year										
1938	5	—	46	9	18	12	6	2	8	14
1939	11	8	48	29	36	13	36	94	34	17
1940	15	13	19	28	46	34	24	37	4	11
1941	28	22	36	.	22	36	14	32	15	3
Bank deposits — percentage increases or *decreases* (–) on year										
1938	8	— *4*	12	— *1*	11	1	4	13	7	— *5*
1939	14	7	15	9	25	— *15*	10	— *2*	5	— *3*
1940	16	15	33	15	47	31	5	33	— *1*	3
1941	5	18	25	30	24	24	20	12	13	2
Bank deposits as percentage of Note Circulation at end of year										
1929	457	434	228	87	48	82	258	303	366	512
1937	300	402	115	101	32	75	265	375	265	214
1938	308	386	89	92	30	67	260	415	262	178
1939	316	383	69	77	28	50	210	210	204	147
1940	318	391	77	69	28	49	178	203	195	136
1941	260	379	71	.	28	45	188	172	192	135

* Excepting the United States, for which the 101 weekly reporting member banks have been taken (as most comparable with the big European commercial banks with many branches), the statistics are confined to the outstanding big banks in each country as follows: United Kingdom, the "big five" banks; Germany, five Berlin Grossbanken; Italy, three banks "of national importance"; France, four large "sociétés de crédit"; Holland, four biggest banks; Denmark, three biggest banks; Finland, three biggest banks; Sweden, four biggest banks; and Switzerland, seven Grossbanken.

These big banks account for about 30 per cent. of all commercial-bank deposits in Germany; about 50 per cent. in Denmark, France and Holland; some 60–70 per cent. in the United States, United Kingdom, and Sweden; and 90 per cent. in Finland.

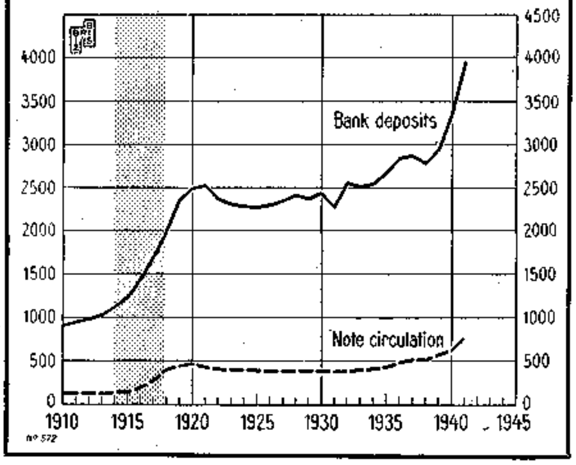
more rapidly than commercial-bank deposits — a reversal of the position in 1940 for the United States, England and Germany, but the continuation of a longer trend, as is indicated in the third section of the table. The changed relationship between note circulations during the period from 1929 to 1941 is very remarkable; but, in comparing the various columns of the table, it must be remembered that some countries (e.g. Germany and Switzerland) had a considerable volume of foreign deposits in 1929 and also that the deposits at the big banks taken have not in all countries the same relationship to total commercial-bank deposits (and, indeed, in any single country this relationship is liable to change).(1) Nevertheless, in spite of the decline since 1929 (and even since 1937), it is beyond doubt that commercial-bank deposits in the Anglo-Saxon countries have a dominating importance as circulating media; while in continental Europe bank-notes are generally of more importance than deposits. As an example: in England deposits at the big banks are nearly four times as high as the amount of bank-notes; in France deposits with the four big banks are less than 30 per cent. and with all the banks less than 60 per cent. of the note circulation.

(1) This was particularly true in the United States last year. Deposits with weekly reporting member banks (of which those of New York banks amount to nearly one-half) rose by only 5 per cent. in 1941, these banks being considerably affected by the fall of excess reserves described in Chapter V, while deposits at all other member banks increased by over 20 per cent. on the year.

It is of particular interest that it is in the Anglo-Saxon countries, where the currencies were brought back to par after the last war, that public discussion of the possibility of inflation has been most intense; and these preoccupations have found their expression in the budget speeches. The President of the United States, in the budget message of January 1942, referred to his warnings of a year previously: "I stated last year in the budget message", he said, "that extraordinary tax measures may be needed to 'aid in avoiding inflationary price rises which may occur when full capacity is approached'. The time for such measures has come." The approach to full capacity in the United States at the end of 1941 was, however, preceded by the European belligerents, and in England the fight against inflation is described in military terms. In April 1942 the Chancellor of the Exchequer stated: "During the last year we have definitely held our own against the onset of inflation. But the enemy is still at our gates and our vigilance must not be relaxed for a moment. We can at least claim that as yet he has not established a bridgehead against our financial defences."

Outside official circles, however, the certainty that some inflation has been, will be and even should be, avoided is not so strong. A London financial journal[1] maintains that "it is not the task of the Treasury to combat inflation to the exclusion of all other considerations, but to finance the war with the minimum of inflation consistent with maximum war production". And the chairman of one of the London clearing banks[2] stated: "No war, least of all the present one, so stupendous in its expenditure, can be waged without a measure of inflation." By this is meant not that some mild inflation is likely to hamper the war effort — in England it may in fact help it — but that during the war the seeds of post-war inflation may be sown. This was put very clearly by another of the bank chairmen[3]: "Last time the worst excesses of over-spending, inflation, speculation and capital expansion came not during, but shortly after, the war, with disastrous consequences that are still remembered. The risk of a similar catastrophe after this war may be all the greater in that restrictions have been more severe." In England budget deficits, in

United Kingdom.*
Note Circulation and Bank Deposits.
At end of year, in millions of £ sterling.



* In this graph Irish bank deposits and the circulation in Eire (both of which are, however, relatively small) have been included in recent years, so that the curves may retain their continuity with the earlier period.

(1) Financial News (leading article), 12th January 1942.
(2) The chairman of the District Bank, in a statement circulated to the annual meeting of shareholders on 30th January 1942.
(3) The chairman of the Midland Bank, in a statement circulated to the annual meeting of shareholders on 29th January 1942.

fact, grew after the war of 1914–18 and the public debt reached its highest point of £6,300 million in 1923 (being ten times higher than it was ten years earlier); the note circulation and the total of deposits with the banking system also continued to rise after the war, as the graph shows.

From £1,000 million in 1913 total commercial-bank deposits rose to £2,500 million in 1921, the note circulation (including an allowance for gold coin before the war and Treasury notes from 1914) rising rather more rapidly from about £120 million towards £500 million in 1920. The post-war slump caused a slight contraction but the purchasing power created during the war remained in bulk. Again, from £2,800 million at the end of 1938, total bank deposits have risen to nearly £4,000 million at the end of 1941, while the note circulation has once again expanded more rapidly.

In times of growing activity in private business an expansion of bank credit against advances and investments presses upon the liquidity of the banks; the proportion of their liquid assets to total deposits declines, while the need to remain liquid increases, as some deposits are withdrawn for use as currency. A certain automatic check is thus placed on the expansion unless the central monetary authorities step in with open-market operations or other means to relieve the stringency. In wartime the automatic checks to credit expansion are purposely removed and, indeed, a polished market technique is employed to keep the banks liquid, a specially necessary adjunct to a cheap-money policy. Only in the United States were serious steps taken in 1941 to reduce the liquidity of the banks, and this was one month before the entry of that country into the war.

It is evident that after the war a situation will obtain requiring wise decisions and firm actions, if the perils of post-war inflation are to be avoided: and in no sphere will this be more urgent than with regard to the budget.

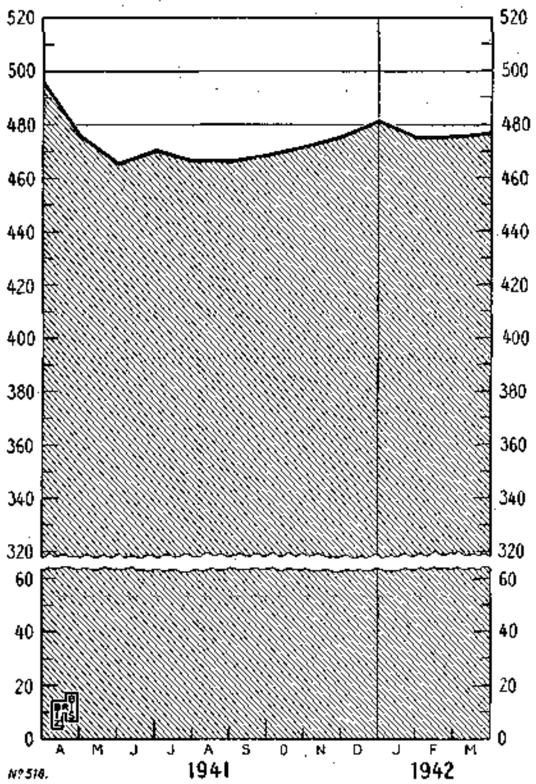
VII. CURRENT ACTIVITIES OF THE BANK.

1. OPERATIONS OF THE BANKING DEPARTMENT.

The balance sheet of the Bank as on 31st March 1942, examined and found correct by the auditors, is reproduced in Annex I to the present Report. It shows a total of 476.6 million Swiss gold francs (of 0.2903.... grammes of fine gold) against 495.8 million on 31st March 1941 and 469.9 million on 31st March 1940. As before, the method of conversion of the currencies represented in the balance sheet is based on the U.S. Treasury's official selling price for gold on the date of the closing of the Bank's accounts, and on the exchange rates quoted for the various currencies against dollars on that date. Except for an increase by 4.14 per cent. in the exchange value of the lira, these rates were practically the same on 31st March 1942 as on 31st March 1941.

The Bank has continued to observe an attitude of strict neutrality, avoiding all operations which could possibly confer an advantage on any belligerent nation at the expense of another. The extension of the area of the war and the intensification of financial and economic warfare (not least in the United States) have led to a further decline in the volume of the Bank's operations, the total turnover being, in fact, less than one-half of the figure reached in the previous financial year. The range of operations still possible, including the management of the Bank's investments in various markets, has, however, enabled it to follow the trend of financial events and gather special experience under present disturbed conditions. In the field of economic studies, the regular work of keeping abreast of monetary and financial developments has been continued as before. Apart from the Annual Report, it was decided to publish compilations of foreign exchange restrictions, for which there has been an active demand.

Total of Assets and Liabilities.
April 1941 to March 1942.
End-of-month figures, in millions of Swiss gold francs.



In the distribution of its assets, the Bank has naturally paid particular attention to the maintenance of full liquidity in the markets where it has commitments. Thus, the Bank holds more than sufficient assets in gold in each of the places where gold deposits are repayable and also has, in the same currencies as the respective deposits, funds at short term and at sight substantially greater, in all cases, than the corresponding commitments.

In the total of the Bank's balance sheet, the monthly movements, which more than ever reflect variations in the deposits made by central banks, are shown in the graph on the preceding page.

During the first two months of the financial year, the balance-sheet total fell from 495.8 million Swiss gold francs on 31st March 1941 to 465.4 million on 31st May, the latter figure being the minimum amount registered during the year. After a recovery to 481.3 million at the end of December, the financial year closed with a total of 476.6 million.

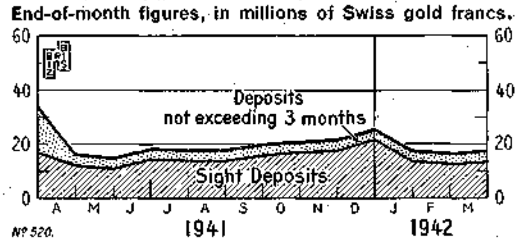
Earmarked gold, not entered in the balance sheet, totalled 65.1 million Swiss gold francs on 31st March 1941. After falling to 49.2 million on 31st October, the amount remained almost stationary, being 51.6 million at the end of the financial year.

A comparison of the principal items in the Bank's balance sheet on 31st March 1941 and on 31st March 1942 calls for the following observations:

1. Among the liabilities, the only movements during the year are found in the volume of short-term and sight deposits.

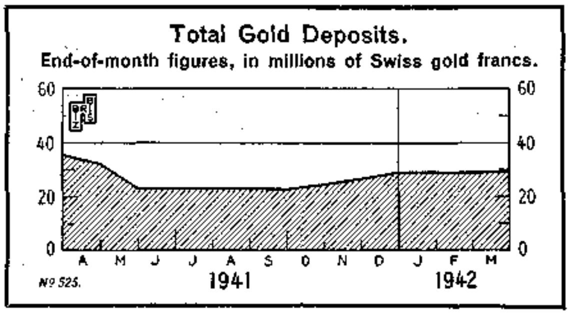
Currency deposits of central banks for their own account fell abruptly from 33.9 million Swiss gold francs at the beginning of the financial year to 14.5 million on 31st May, recovering to a figure of 25.4 million on 31st December but falling again to 17.3 million at the end of the financial year. The decline during the year was most pronounced in the deposits for a term not exceeding three months, which dropped from 16.9 million Swiss gold francs on 31st March 1941 to 4 million at the end of the financial year.

Short-term and Sight Deposits
of Central Banks for their own account.
End-of-month figures, in millions of Swiss gold francs.



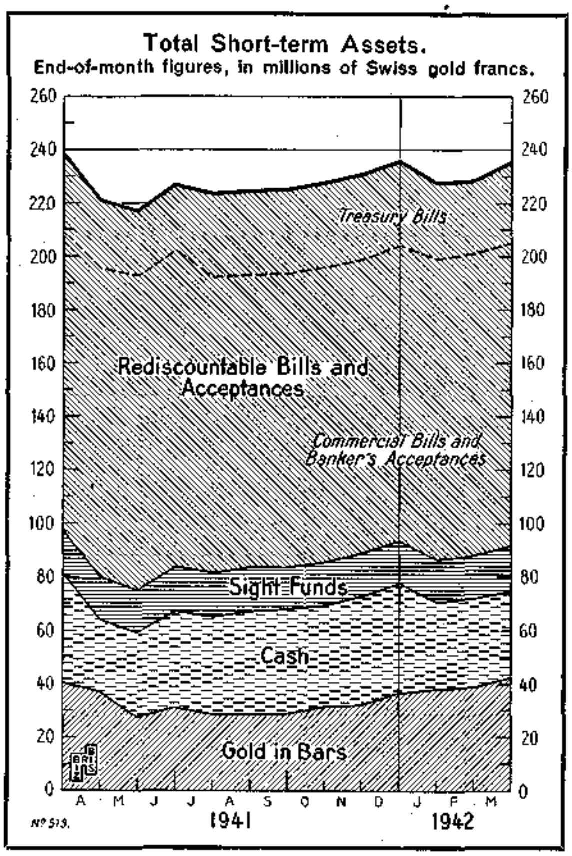
Sight deposits of central banks for account of third parties changed little during the year, amounting to 1.3 million Swiss gold francs on 31st March 1942, while deposits of other depositors, almost exclusively sight deposits, rose from 1.2 million Swiss gold francs on 31st March 1941 to 4.6 million on 31st March 1942.

Deposits expressed in a weight of gold declined from 35.6 million Swiss gold francs at the beginning of the financial year to 22.8 million on 30th June, finishing the financial year with an amount of 29 million, divided among twenty-four different accounts. For the settlement of postal payments, fairly regular use was still made of the facilities offered by this particular type of account.



2. On the assets side, movements in the total of gold in bars in the course of the year were in conformity with the variations in the Bank's commitments expressed in a weight of gold, except that the Bank gradually increased its own stock of gold (i. e. gold held in excess of gold commitments) in order to ensure under present conditions a more suitable distribution of its resources as between gold and currencies. On 31st March 1941 the amount held as gold in bars was equivalent to 40.1 million Swiss gold francs, of which 4.5 million represented the Bank's own gold, while at the end of the financial year the total gold stock was 42.1 million Swiss gold francs (the highest level since July 1939), with the Bank's own gold at 13 million.

After a fall from 41 million to 27.4 million Swiss gold francs in the first month of the financial year, the cash held in different currencies rose to 41.5 million on 31st December. From that point a steady decline connected with the Bank's purchases of gold brought the figure down to 33 million on 31st March 1942. At the end of the financial year the aggregate amount of the Bank's gold and cash holdings was 75 million Swiss gold francs against 81.1 million a year earlier.



The total of sight funds invested at interest remained in the neighbourhood of 16 million Swiss gold francs throughout the financial year, the final figure being 16.3 million.

The total of the rediscountable portfolio also showed little change. From 141.3 million Swiss gold francs on 31st March 1941, it rose to 144 million on 31st March 1942. The slight increase was almost wholly accounted for by a rise in the holdings of bills and acceptances from 111.6 million to 114.1 million Swiss gold francs in the course of the financial year, the amount of Treasury bills moving only from 29.6 million to 29.9 million Swiss gold francs.

Among the assets of the Bank not shown in the above graph, time funds invested at interest have varied little, the figures registered at the beginning and at the end of the financial year being 21.5 and 21.1 million Swiss gold francs respectively.

The distribution of sundry bills and investments at the beginning and at the end of the financial year is shown in the following table.

In millions of Swiss gold francs	31st March 1941	31st March 1942
Maturing within 3 months	108.4	77.9
3 to 6 months	57.2	35.8
Over 6 months' maturity .	67.8	106.3
Total . . .	233.4	220.0

The totals at the beginning and at the end of the financial year are at the same time the maximum and minimum figures reached for these bills and investments during the year. The lengthening of the average period of investment is connected with an increase in the proportion of the Bank's own funds in relation to its total liabilities and reflects a tendency on its part to improve, in some measure, the earnings on the amounts invested in the different markets.

During the year the Bank has received — with a single exception — all the interest due on its investments in various markets and has regularly been able to reinvest any amounts maturing. In the exceptional case mentioned, the Bank secured payment of about a million Swiss gold francs corresponding to fifteen months' interest in October 1941 and negotiations are now in progress for a further payment. As in the past, the Bank has been fortunate in obtaining the helpful assistance of the central banks and other monetary institutions with which it is working.

In addition to the regular repayments by the National Bank of Hungary provided for under the arrangement of 1940, mentioned in the Eleventh Annual Report, an exceptional repayment was received in 1941, with the result that on 31st March 1942 the Bank's investments in Hungary were little more than half their total at the beginning of the financial year. A partial reimbursement prior to the due date has also been received on another market.

The volume of gold operations in the year under review was materially less than in the previous financial year. Present conditions are obviously rather unfavourable for such operations, especially in view of the almost complete interruption of gold transport across the Atlantic.

The use made of the Bank as a channel between central banks to facilitate the financing of international trade has practically ceased, this branch of the Bank's activity being barely kept alive by a limited number of transactions with two neutral central banks.

On the other hand, the Bank has continued to act as banker for the international Red Cross organisations operating from Switzerland and has also in other ways been able to render them technical assistance. The Bank is happy to partake to some extent in this charitable work of an international and neutral character.

2. TRUSTEE AND AGENCY FUNCTIONS OF THE BANK.

During the year under review, there has been no change or development in the Trustee and Agency functions of the Bank, which were described on pp. 155 and 156 of the Bank's tenth Annual Report.

3. NET PROFITS AND DISTRIBUTION.

It is for the present General Meeting to consider the declaration of a dividend. The net profit for the year, after making allowance for contingencies, is 5,185,685.90 Swiss gold francs, the Swiss gold franc being as defined by Art. 5 of the Bank's Statutes, i. e. the equivalent of 0.290 322 58 .... grammes fine gold. This compares with a figure of 5,293,909.12 Swiss gold francs for the eleventh fiscal year. For the purpose of the Balance Sheet as at 31st March 1942, the foreign currency amounts of the assets and liabilities have been converted into Swiss gold francs on the basis of the quoted or official rates of exchange for the respective currencies on that date, and all assets are valued at or below market quotations, if any, or at or below cost.

After providing for the Legal Reserve that is required by Article 53 of the Statutes, to an amount equal to 5 per cent. of the net profits, i. e. 259,284.30 Swiss gold francs (1941: 264,695.46 Swiss gold francs), there remain 4,926,401.60 Swiss gold francs available for the payment of a dividend. It is recommended that the General Meeting declare a dividend at the rate of 6 per cent. per annum in respect of the twelfth fiscal year and that, in order to complete the sum of 7,500,000 Swiss gold francs required for this purpose, an amount of 2,573,598.40 Swiss gold francs be taken from the Dividend Reserve Fund. This would further reduce the Dividend Reserve Fund from 4,200,538.73 Swiss gold francs to 1,626,940.33 Swiss gold francs. The aggregate of the Legal, Dividend and General Reserves at the end of the twelfth year would then be 21,009,077.91 Swiss gold francs.

The accounts of the Bank and its twelfth Annual Balance Sheet have been duly audited by Messrs Price, Waterhouse & Co., Zurich. The Balance Sheet will be found in Annex I, as well as the certificate of the auditors to the effect that they have obtained all the information and explanations they have required and that in their opinion the Balance Sheet, together with the note thereon, is properly drawn up so as to exhibit a true and correct view of the state of the Bank's affairs according to the best of their information and the explanations given to them and as shown by its books. The Profit and Loss Account and the Appropriation Account are reproduced in Annex II.

4. CHANGES IN THE BOARD OF DIRECTORS.

The term of office of both M. Galopin and Mr Kano as Vice-Chairmen of the Board expired on 7th May 1942.

Certain members of the Board whose term of office under Article 28 (2) of the Statutes expired in the early months of 1942 were duly reappointed by their respective ex-officio Directors.

Herr Ernst Weber, President of the Direktorium of the Swiss National Bank, has been re-elected, under Article 28 (3) of the Statutes, to serve for a further period of three years.

VIII. CONCLUSION.

A great war has a double aspect: on the one hand, severance of relations with enemies and, on the other, a closer association among countries on the same side of the barrier. Thus, contrasting with the element of isolation, an active element of collaboration is present. In planning for the future, this element of collaboration is regarded as essential by all parties, not least in the field of economic and monetary relationships. This is not surprising: little demonstration is needed — indeed, war conditions provide the evidence — that no single country can become wholly self-sufficient, each being of necessity part of a wider economy. But a difference in conception exists whether this wider economy should be on a world basis or whether collaboration should, in the first place, be worked out in separate, politically defined areas, with arrangements for trade between these areas as larger entities. Nevertheless, it is common ground that a greater degree of economic collaboration must be achieved than, for instance, was realised in the period between the two wars, marked as it was by so many measures taken for the sake of narrow national ends, irrespective of their repercussions on the general welfare.

The conception that better economic collaboration is a necessity in the modern world, so often stressed in official declarations, has unmistakably taken root in the minds of a wider public, in spite of the nationalism engendered by the war. This same public is certainly aware that difficulties beset the creation of a system based on collaboration, but it feels instinctively that a way can and must be found to establish effective cooperation without impairing the vital interests of individual countries.

The problems are many and various. It is not easy to define the monetary and commercial obligations to which a country should subscribe in order to fit its policy into the general economic scheme. Institutions competent to deal with particular sets of problems will be needed, but undertakings must also be given by the various countries setting some limit to their power to alter, unilaterally and without regard to the interests of their neighbours, the exchange value of their currencies or the main lines of their commercial practice. Collaboration, if it is to be real, must mean some adaptation of national policies to the requirements of a common development, and this implies readiness to make not only adjustments but positive contributions to joint endeavours. Merely to subscribe to general principles or to concentrate on concessions to be made by others will be of little avail. An individual country may feel keenly the sacrifice involved in some of the measures to be adopted, but the result of the alignment should be to ensure a higher degree of lasting welfare for each country than it would be able to attain by itself. Experience has proved that the policy, only too often adopted before this war, of protecting the immediate interests of a particular economy by creating hindrances to trade, leads to such disturbances in the world generally that even the country applying the policy fails to attain the ends envisaged. During the war, with the growing scarcity of supplies, each country is naturally anxious to encourage imports, but the methods employed are largely unsuited to conditions of normal peaceful intercourse. The new lines to be struck — different in so many respects both from those tried before and from those applied during the war — must be inspired by the belief that, with modern potentialities of production, the prosperity of a single nation need not and, indeed, cannot be won at the expense of others, and that it is therefore short-sighted to embark upon a policy without regard to the effects it will produce in other countries.

ANNEXES

BALANCE SHEET

IN SWISS GOLD FRANCS (UNITS OF 0.29032258...

ASSETS			
			%
I—GOLD IN BARS		42,082,396.06	8.9
II—CASH On hand and on current account with Banks		32,962,453.81	6.9
III—SIGHT FUNDS at interest . .		16,340,546.99	3.4
IV—REDISCOUNTABLE BILLS AND ACCEPTANCES			
1. Commercial Bills and Bankers' Acceptances	114,158,585.20		24.0
2. Treasury Bills	29,886,659.98		6.3
		144,045,245.18	
V—TIME FUNDS at interest Not exceeding 3 months . . .		21,068,707.65	4.4
VI—SUNDRY BILLS AND INVESTMENTS			
1. Treasury Bills	74,464,835.62		15.6
2. Railway, Postal Administration and Other Bills and Sundry Investments	145,497,970.97		30.5
		219,962,806.59	
VII—OTHER ASSETS		183,979.08	0.0
		476,646,135.36	100.0

NOTE — The Bank holds assets in gold at each of the places where gold deposits are repayable and in short-term and sight funds in the same currencies as the corresponding deposits, in all cases substantially greater than the deposits in question (Items IV and V — Liabilities).

The use of dollar assets and bar gold held in the U. S. A. is subject, under wartime regulations, to U. S. Treasury license. As regards assets held in countries whose currencies are subject to exchange restrictions, the Governments concerned have, either as signatories of the Hague Agreement of 1930 (Article X) or by special measures, declared the Bank to be immune "from any disabilities and from any restrictive measures such as censorship, requisition, seizure or confiscation, in time of peace or war, reprisals, prohibition or restriction of export of gold or currency and other similar interferences, restrictions or prohibitions". Moreover, after providing for the German Government Deposit out of investments in Germany, nearly 60% of the assets then remaining are covered by special contracts guaranteeing their gold value.

The Bank's commitment in respect of the Annuity Trust Account Deposits is not clearly established, but it is stated at its maximum amount in Swiss Gold Francs.

For Balance Sheet purposes the currency amounts of the assets and liabilities have been converted into Swiss Gold Francs on the basis of quoted or official rates of exchange for the respective currencies.

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS
OF THE BANK FOR INTERNATIONAL SETTLEMENTS, BASLE.

In conformity with Article 52 of the Bank's Statutes, we have examined the books and accounts ation and explanations we have required and that in our opinion the above Balance Sheet, together Bank's affairs according to the best of our information and the explanations given to us and as shown currencies concerned.

ZURICH, May 2, 1942.

AS AT MARCH 31, 1942

GRAMMES FINE GOLD — ART. 5 OF THE STATUTES)

LIABILITIES			%
I—CAPITAL			
Authorised and issued 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
of which 25% paid up		125,000,000.—	26.2
II—RESERVES			
1. Legal Reserve Fund	5,780,203.15		
2. Dividend Reserve Fund . . .	4,200,538.73		
3. General Reserve Fund . . .	13,342,650.13		
		23,323,392.01	4.9
III—LONG TERM DEPOSITS			
1. Annuity Trust Account Deposits	152,606,250.—		32.0
2. German Government Deposit	76,303,125.—		16.0
		228,909,375.—	
IV—SHORT TERM AND SIGHT DEPOSITS (various currencies)			
1. Central Banks for their own account:			
(a) Not exceeding 3 months	3,968,900.—		0.8
(b) Sight	13,354,565.86		2.8
2. Central Banks for the account of others:		17,323,465.86	
Sight		1,267,341.84	0.3
3. Other depositors:			
(a) Not exceeding 3 months	24,344.68		0.0
(b) Sight	4,541,366.73		1.0
		4,565,711.41	
V—SHORT TERM AND SIGHT DEPOSITS (Gold)			
1. Not exceeding 3 months . .	1,464,753.74		0.3
2. Sight	27,579,932.38		5.8
		29,044,686.12	
VI—MISCELLANEOUS		42,026,477.22	8.8
VII—SURPLUS			
Profit for the financial year ended March 31, 1942 . . .		5,185,685.90	1.1
		476,646,135.36	100.0

of the Bank for the financial year ending March 31, 1942, and we report that we have obtained all the inform-
with the Note thereon, is properly drawn up so as to exhibit a true and correct view of the state of the
by the books of the Bank, as expressed in the above-described Swiss gold franc equivalents of the

PRICE, WATERHOUSE & Co.

PROFIT AND LOSS ACCOUNT

for the financial year ended March 31, 1942

		Swiss gold francs
Net Income from the use of the Bank's capital and the deposits entrusted to it, after necessary allowance for contingencies		6,976,870.40
Commissions earned :—		
As Trustee (or Fiscal Agent to Trustees) for International Loans		106,931.95
In connection with special credits		3,373.17
Transfer fees		18.28
		7,087,193.80
Costs of Administration :—		
Board of Directors — fees and travelling expenses	78,610.27	
Executives and staff — salaries and travelling expenses	1,477,756.68	
Rent, insurance, heating, light and water	97,267.94	
Consumable office supplies, books, publications	94,783.55	
Telephone, telegraph and postage	35,381.75	
Experts' fees (Auditors, interpreters, etc.)	11,578.01	
Cantonal taxation	35,424.62	
Tax on French issue of Bank's shares	26,209.81	
Miscellaneous	44,495.27	1,901,507.90
NET PROFIT :—		5,185,685.90

APPROPRIATION ACCOUNT

NET PROFIT FOR THE FINANCIAL YEAR ENDED MARCH 31, 1942	5,185,685.90
To the Legal Reserve Fund in accordance with Article 53 (a) of the Statutes, — 5 % of 5,185,685.90	259,284.30
Available towards a dividend for the year	4,926,401.60
From the Dividend Reserve Fund	2,573,598.40
Dividend at the rate of 6 % per annum on paid-up capital	7,500,000.—

BOARD OF DIRECTORS*

Dott. V. Azzolini, Rome
Y. Bréart de Boisanger, Paris
Baron Brincard, Paris
Walther Funk, Berlin
Alexandre Galopin, Brussels
Prof. Francesco Giordani, Rome
Hisaakira Kano, London
Sir Otto Niemeyer, London
Montagu Collet Norman, London
Ivar Rooth, Stockholm
Dr. Hermann Schmitz, Berlin
Kurt Freiherr von Schröder, Cologne
Dr. L. J. A. Trip, The Hague
Marquis de Vogüé, Paris
Ernst Weber, Zurich
Yoneji Yamamoto, Berlin

Alternates

Dott. Giovanni Acanfora } Rome
Dott. Mario Pennachio }
Cameron F. Cobbold, London
Emil Puhl, Berlin

EXECUTIVE OFFICERS

Thomas H. McKittrick	President
Roger Auboin	General Manager
Paul Hechler	Assistant General Manager
Dott. Raffaele Pilotti	Secretary General
Marcel van Zeeland	Manager

Dr. Per Jacobsson	Economic Adviser
Dr. Felix Weiser	Legal Adviser

* The question of the Belgian ex-officio Director and his Alternate is in abeyance.

8th June 1942.