BANK FOR
INTERNATIONAL SETTLEMENTS

ELEVENTH ANNUAL REPORT

1st APRIL 1940 — 31st MARCH 1941

BASLE

9th June 1941

TABLE OF CONTENTS

		Page
I.	Introduction	5
II.	Exchange Rates, Foreign Trade and Price Movements	26
III.	Production and Movements of Gold	89
IV.	International Capital Movements	98
V.	Government Finance, Money and Capital Markets and the Stock Exchanges	111
VI.	Central Banking Developments	176
VII.	Current Activities of the Bank:	
	(1) Operations of the Banking Department	184
	(2) Trustee and agency functions of the Bank	189
	(3) Net profits and distribution	189
	(4) Changes in the Board of Directors	190
VIII.	Conclusion	191

ANNEXES

I. Balance sheet as at March 31, 1941.

II. Profit and Loss Account and Appropriation Account for the financial year ended March 31, 1941.

ELEVENTH ANNUAL REPORT

TO THE ANNUAL GENERAL MEETING OF THE BANK FOR INTERNATIONAL SETTLEMENTS

Basle, 9th June 1941.

Gentlemen,

I have the honour to submit to you the Annual Report of the Bank for International Settlements for the eleventh financial year, beginning 1st April 1940 and ending 31st March 1941. The results of the year's business operations are set out in detail in chapter VII. Net profits, after provision for contingencies, amount to 5,293,909.12 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. 264,695.46 Swiss gold francs, there remain available for the payment of a dividend 5,029,213.66 Swiss gold francs, corresponding to about 4 per cent. of the paid-up capital. The Special Reserve Fund has been drawn upon to the extent of 2,470,786.34 Swiss gold francs in order to permit the distribution of an annual dividend of 6 per cent. The balance-sheet total has risen from 469.9 million Swiss gold francs to 495.8 million Swiss gold francs on 31st March 1941, the rise being due to higher deposits from central banks.

The Bank for International Settlements has been granted all reasonable opportunities for the conduct of its business, which has thus continued notwithstanding the difficulties of the international situation. The Bank has adhered to the principles of scrupulous neutrality which it laid down for itself in the autumn of 1939, confining its activities strictly to transactions whereby no question can possibly arise of conferring economic or financial advantages on any belligerent nation to the detriment of any other.

In the period up to 31st March 1940, which was reviewed in the last Annual Report of the Bank, actual warfare in Europe had been limited to certain relatively restricted areas and at the end of the period 50 per cent. of the population of Europe (excluding the U. S. S. R.) belonged to neutral or non-belligerent countries. Trade was still carried on in a substantial volume between most countries in Europe and overseas markets, and over a large area the economic and financial life although increasingly coloured by the state of war did not radically differ from the conditions which had obtained before the autumn of 1939.

Developments in the spring and summer of 1940 and the hardening of the struggle in the winter extended the area of the conflict, so that at the end of March 1941 the proportion of European population which had not been directly involved in the war was less than 15 per cent. of the total. Actual destruction of life and property had not been on an extensive scale in relation to total population and wealth but the disruption to which the peacetime economic organisation was exposed, not least through the incisive changes in the customary channels of trade, created a series of new and difficult problems and, in the areas most exposed, profoundly affected the conditions of daily life. With few exceptions the countries on the Continent of Europe have had their commercial relations with overseas markets reduced to a minimum and as a result this continent has been compressed into an economic group with a population of over 300 million people dependent in the main on its own resources.

For the United Kingdom, which for food alone is dependent to the extent of about three-quarters of its requirements on foreign sources, the cutting-off of supplies from Europe has increased the importance of her Atlantic traffic with other continents and necessitated a concentration on the imports of the most vital foodstuffs and materials. The great reduction in the shipments to European countries has been felt keenly in Latin America where surplus stocks have accumulated and the consequent reduction in the income from abroad has led to exchange difficulties, which, however, have been eased to a considerable extent by loans obtained principally from government agencies in the United States and, in the case of the Argentine, Brazil and Mexico, also by the inflow of refugee capital and funds for investment. In the United States rapid increases in spending for armaments have raised the level of domestic production to an all-time record and increased sales to the British Empire and Latin America have, as far as industry is concerned, compensated for the loss of other foreign markets, while surplus agricultural products have been laid up in stocks through government purchases and the granting of loans on easy terms. As regards the Far East, Japanese exports to countries of the yen bloc have expanded so rapidly that in 1940 they surpassed the country's other exports and gave rise to the imposition of government control to ensure a more balanced distribution of the export trade in accordance with the need of foreign exchange. In almost every corner of the world the various countries have more and more been thrown back upon their own resources, which they have been compelled to exploit in the fullest possible measure, leading to an extreme autarky beyond the desires of any government. That in this respect the present state of affairs is largely regarded as a temporary development to be reversed as soon as peace returns and commercial relations can be resumed may be seen from official declarations in practically all countries, however much opinions may differ as to the most suitable means of attaining a durable trade recovery.

If it is not possible for the time being to speak of "world economy", it follows that a review of actual conditions in the year that has passed must be concerned mainly with the particular conditions within separate groups of countries. There are, however, many features in common in the various groups and some of the most pressing economic and financial problems of the day, e. g., the meeting of heavy budget deficits, reveal a great degree of similarity throughout the world, as also do the solutions adopted, there being many practical arrangements which by force of circumstances impose themselves irrespective of enmities or ideologies.

Besides the severance of commercial relations through the blockade and counter-blockade the increase in armament expenditure, first and foremost in the belligerent but also in other countries, is the outstanding fact which dominates commercial and financial developments. This increase represents the budgetary expression of a great diversion of national effort towards armaments — through the mobilisation of men for active service, the manufacture of arms and ammunition, transport of troops and material, etc. The proportion of public expenditure (central and local) to national income already exceeds that of the last two years of the 1914–18 war. On account of changes which have taken place in prices and earnings since the summer of 1939 it is more than ever difficult to calculate the magnitude of national incomes. But there seems to be little doubt that in Germany, Italy and the United Kingdom total public expenditure in 1941 will amount to 70 per cent. or more of the net national income*; and even in some of the neutral countries, as, for instance, Sweden, public expenditure takes as much as 40 per cent. The state has become the main customer of industry and trade and the main — if not the exclusive — borrower on the money and capital markets. This preponderance of the state must in many ways affect the character of the economic and financial measures, for the state does not "react" in the same way to changes in interest rates, price alterations, etc. as the mass of private businesses and individuals may ordinarily be expected to do. There remains, however, in all economies a certain "free sector", the reactions of which must be taken into account to a degree that depends upon its importance in each case.

The concentration of so much of the national effort upon armaments raises two closely related problems: how to put at the disposal of the state, with the least possible disturbance to the monetary system, the financial resources required to meet the increased expenditure, and how to ensure in the most efficient manner the adjustments of production and foreign trade necessary to obtain a maximum of war effort, while still providing sufficient goods for general consumption and other indispensable needs. Financially the problem is one of taxation and borrowing, and economically one of allotting to their right purposes the men and materials available from

---

* The high percentages given in the text represent the ratio between total public expenditure and **net** national income. But other resources than those which form part of the **net** national income are drawn upon: internally, amounts are released from embodiment in fixed and working capital and, externally, resources may be made available from sales of gold, foreign loans, mobilisation of foreign investments, contributions from other countries for occupation costs, etc. That public expenditure amounts to more than 70 per cent. of the *national income does* **not** *mean that less than 30 per cent. remains for private consumption. In the* United Kingdom it has been calculated that in the last quarter of 1940 total expenditure of central and local governments constituted 67 per cent. and consumption 63 per cent., together 130 per cent. of the net national income. Not less than 30 per cent. was thus covered by "disinvestment", probably mainly the employment of dollar resources.

domestic and foreign sources. The main objective for a belligerent country is that of gaining in strength to win the war, while remembering that maintenance of economic and financial order is an important element in withstanding the emergency strain. It is noticeable that memories — whether systematically analysed or not — of the last war and post-war period play a considerable rôle in framing present policy and in determining the attitude of the public towards many current developments. Anxiety is felt lest there should again be a steep rise in prices either degenerating into a wild inflation, as was the experience of not a few countries in Europe after the last war, or followed by a devastating deflation with heavy business losses and widespread unemployment not less dangerous from a social point of view. More foresight should now be exercised to avoid a repetition of similar calamities. It is this attitude of mind which at least partly explains the imposition, in so many countries, of heavy taxation, control of prices and of costs, rationing of essential commodities and in general the more speedy establishment of an all-round war economy. While this is the predominant note it is, however, necessary to mention that among certain heavily indebted circles — especially farming communities — there is found, if not a direct desire for, at least a certain willingness to acquiesce in, an inflationary movement, which would raise the prices of their products and thus help to alleviate the burden of existing debts, in some cases a remainder of speculative excesses during and immediately after the last war.

As to the financing of the increased state expenditure there is — with the exception perhaps of certain inflation-minded groups — general agreement on the desirability of meeting as much as possible of the expenditure by taxation, the main reasons being that this method of financing involves less danger of inflation and will make it easier to grapple with the difficult post-war problems of heavy dead-weight debts. No country has, however, been able or willing to impose sufficient taxation to meet more than a part of the rapidly mounting outlay of the present emergency period. Without minimising the importance of political and psychological opposition to high new taxes and the consequent temptation of those concerned to follow the line of least resistance, it should be pointed out that in a period of financial strain the state must tap all sources of obtainable means and that genuine savings as well as the amounts currently released from embodiment in fixed capital (building, equipment, etc.) or in working capital (goods in process or in store) can best be absorbed by way of borrowing. As a matter of fact, of the two countries which have most effectively increased their taxation — Germany and the United Kingdom — the former was able to meet just over, and the latter somewhat under, 40 per cent. of its total military and other expenditure by current revenue, relying for the remainder upon the proceeds of long and short-term borrowing and the employment of foreign resources. According to the latest available figures (which can at best be only approximately correct) the yield of central and local taxation in Germany corresponds to 35 per cent. of the net national income; in the United Kingdom 30 per cent.; in the United States and Sweden 22 per cent.;

in Switzerland 20 per cent.; and in Italy 25 per cent. for central taxation only. Compared with the war of 1914–18 much greater efforts have now been made to increase the proceeds of taxation. In the case of very high incomes 70 to 80 per cent. is often paid and income from capital is sometimes subject to even higher rates. When taxation becomes so high that the amounts due cannot be paid out of current income but the taxpayer is forced to draw on his accumulated reserves, it may exceptionally happen that such taxation is inflationary in its effect. Business profits swollen by the war are usually subject to very heavy rates on the principle — usually applied more strictly to industrial enterprises than to other occupations — that nobody should profit from war. It is sufficient to cast a glance at the distribution of private income in a modern society, as set out in the following tables, to realise that income from interest and dividends cannot carry the whole burden of meeting the increased state expenditure.

Germany – Percentage distribution of private income.(1)

Percentages	Agriculture and forestry (2)	Trade, crafts and liberal professions	Wages and salaries	Interest and dividends distributed	Rents of houses, etc.	Pensions, etc. (3)
1913	13.1	21.1	47.5	13.1	2.0	3.2
1929	7.5	16.0	58.5	4.4	1.2	12.4
1937	8.4	17.9	57.7	4.2	1.4	10.4

(1) Excluding income of public bodies, undistributed corporate income, employers' contribution to social insurances, etc.
(2) Income of farmers, including rental value of their own dwellings.
(3) Officials' pensions, old age pensions, war pensions, unemployment and other social benefits.

United States – Percentage distribution of realised private production income by kind.

Percentages	Salaries and wages	Entrepreneurial income *	Dividends	Interest	Net rents and royalties
1913	61.1	24.5	7.6	4.2	2.6
1929	66.7	19.0	8.4	3.8	2.1
1937	68.0	20.2	7.8	2.2	1.7

* Includes income of farmers, independent shopkeepers, artisans, etc.

Since salaries and wages represent by far the largest and a relatively constant proportion of the national income, the contraction of private spending, which becomes necessary to counter-balance the increase in public spending, must not least affect the position of wage and salary earners. A typical development of recent years has been the introduction of turnover taxes in countries which previously objected to this particular form of taxation because of the harm which it was liable to do to the volume of business and because of the burden which it placed on the great mass of consumers.

At the moment these objections have, however, less weight (and have in part become even positive advantages): it is now a desirable result to reduce the amount of private purchases; and to avoid an unfair distribution of the burden it is generally provided that necessities (certain kinds of foodstuffs, low rents, etc.) are exempt from the tax; moreover, if the tax system in a country is regarded as a whole, the wealthier classes make their higher contribution through steep increases in direct taxation. In Germany, where the turnover tax was introduced during the war of 1914—18, it is now levied at the rate of 2 per cent. and in principle applied at several stages of manufacture, so that the average rate imposed is probably about 6 per cent. of the final selling price. A similar mode of collection is applied in Italy, where the rate is 2 per cent. but where the real burden is probably 5 per cent. of the final selling price of the commodities subject to the tax, and in Holland, where the rate is also 2 per cent. In France the tax is levied once only but at a variable rate rising from 2 to 10 per cent. In the United Kingdom also the tax is applied only once and is at the rate of $16^{2}/_{3}$ per cent. for ordinary goods (with many exceptions) and $33^{1}/_{3}$ per cent. for luxuries (on the retail price). In Sweden, under the same system of collection only once, the rate is 5 per cent., in Finland 4 to 11 per cent., in Denmark 11 per cent. with higher rates for luxuries; while in Switzerland a rate of 2 per cent. applied once only has been adopted. The turnover tax usually brings in a substantial revenue, which in part may be regarded as a compensation for the decline in the yield of customs duties found almost everywhere as a result of the hindrances to foreign trade.

Turnover Taxes and National Income Estimates.

Country	Unit of currency	Yield of turnover taxes	National Income	Yield in relation to national income
		millions	millions	%
Germany	Rmk.	3,500	100,000	3.5
Italy	Lira	4,500	125,000	3.6
Sweden	Kr.	200	11,000	1.8
Switzerland	Fr.	35	8,200	0.4
United Kingdom . . .	£	70	5,600	1.3

When the state borrows to meet expenditure not covered by taxation it may avail itself of the following resources without resorting to inflationary financing:

(i) It can draw on voluntary savings, including not only the amounts saved by individuals from their current incomes but savings made by business corporations, public funds and other bodies, which add to their resources out of current earnings. The importance of savings by companies may be seen from the fact that, according to calculations made by Colin Clark, net investments in the United Kingdom amounted in 1935 to £305 million, of which nearly three-quarters was represented by undistributed profits of companies. The rate of savings varies considerably in different countries — from a high level of 15 to 18 per cent. of the national income in Switzerland (in a normal year) to probably 7 per cent. in Hungary and an even smaller percentage in some Latin American countries. It is, of course, in the general interest that voluntary savings should be increased in times of war emergencies, and rationing of commodities, limitation of dividends, as well as appeals to patriotism and other forms of propaganda are used to that end. The element of social and other compulsions which these measures involve has generally contributed to increase the volume of savings far above peacetime levels. In the English budget for the financial year 1941–42 a system of "forced savings" was introduced: the so-called personal and earned income "allowances" (deducted from income for the calculation of income tax) were reduced but the extra tax payable as a result of the reduction will be credited to the taxpayer, after the war, in the Post Office Savings Bank.

(ii) Another source which, at least in part, may be tapped by borrowing is the amounts currently set aside by business firms and others to cover the depreciation and other forms of wastage of fixed capital or realised through the reduction of stocks. The magnitude of the amounts so set aside may be judged from the following estimate of gross and net capital formation in Sweden during 1938:

Capital formation in Sweden during 1938.

In millions of S. Kr.	New production or new acquisitions	Depreciation	Net capital formation
Buildings	1,417	290	1,127
Means of transport	314	111	203
Machines and Inventories .	889	533	356
Total . . .	2,620	934	1,686

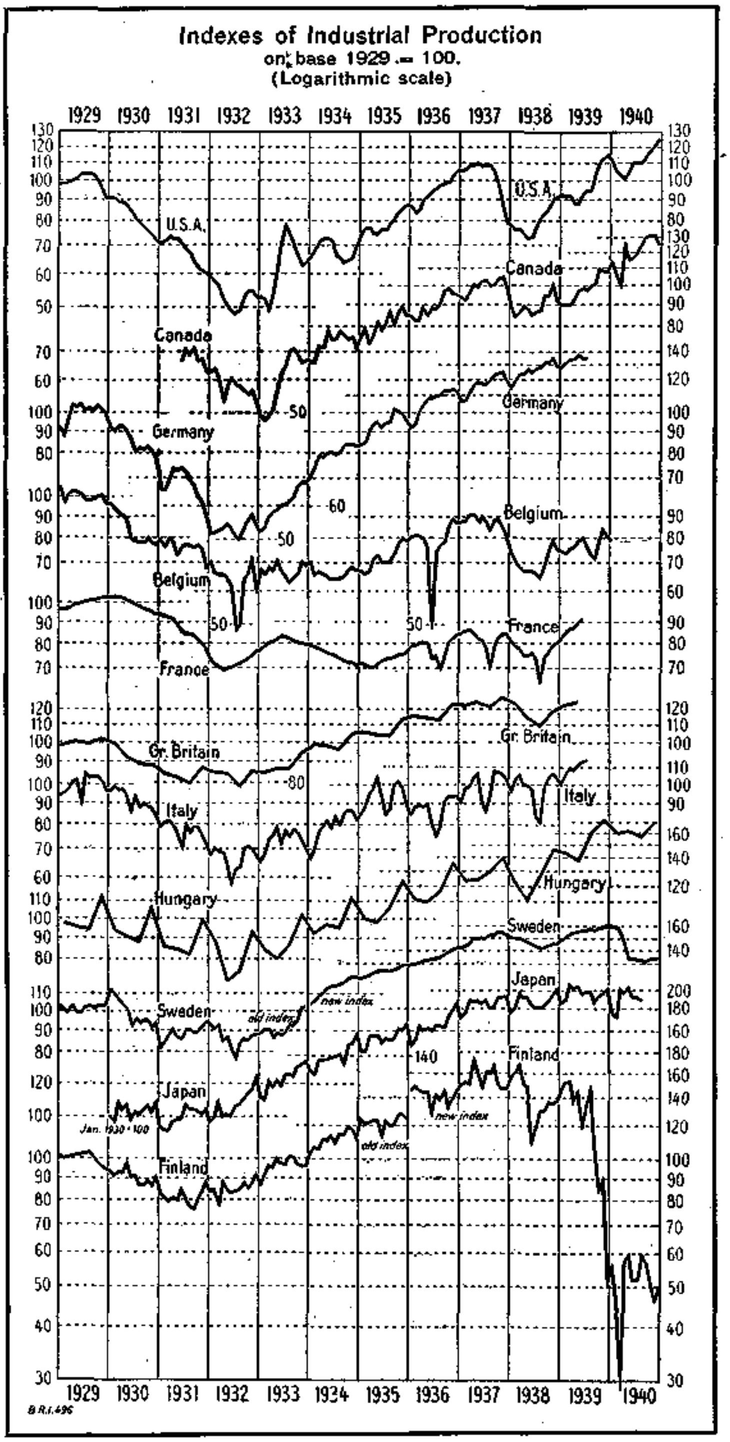
In Sweden the net national income in 1938 was about S.Kr. 11 milliard, of which 1 milliard was absorbed by public administration, about 8.3 milliard by private consumption and nearly 1.7 milliard by net capital formation, while the allowances for depreciation of buildings and other fixed capital (which are additional to the net national income) amounted to over S.Kr. 900 million, as shown above. The whole amount set free by the allowances for depreciation is not, of course, available for state financing since many enterprises (even outside the war industries) must maintain or even increase their plant and inventories. Over a large field, however, there will probably be a postponement of maintenance, sometimes also of repairs; and there are reasons to believe that since the war began many firms have increased the amounts written off beyond normal limits to provide for exceptional losses or increased cost of new equipment and to constitute hidden reserves with a view to future contingencies.

With regard to working capital, it is usually difficult to indicate statistically variations in commodity stocks; but it is common knowledge that in a number of European countries such stocks have been reduced since the war began largely because they could not be replenished; in this way also financial resources are made available for investment in government securities. When the war is over the owners of funds previously released from fixed and working capital will as a rule seek to restore their business position. At the present time they may therefore wish to invest the amounts set free in assets with a high degree of liquidity and the governments naturally provide suitable forms of investment to meet these wishes.

(iii) A third source for government financing is provided by foreign assets whether already available as monetary reserves or obtained through the mobilisation of domestic holdings of foreign securities and direct foreign investments or through the conclusion of foreign credits. In a number of countries the governments have borrowed directly from the central bank to obtain the gold or foreign exchange needed to pay for purchases abroad; such borrowing has not been inflationary in its effect since it has not increased the volume of purchasing power on the domestic market.

Apart from foreign credits and other forms of external assistance the governments are limited in their employment of foreign resources by the magnitude of the gold and foreign exchange reserves and the domestic holdings of saleable foreign investments which may be acquired. As regards borrowing on the home market no such strict limits apply. It is sometimes said that in wartime no government is hampered by difficulties of finance; and this may be taken to mean that the governments can always turn to their own banking systems for the necessary advances to meet current expenditure. Indeed, the "creation of credit" by central and commercial banks is often said to constitute a special source of finance additional to voluntary savings and releases from fixed and working capital. Since government borrowing in most belligerent and other countries is made largely from commercial banks it is of importance to examine at least briefly the nature of this source of financing.

If the government borrows funds it needs by loans taken up by private investors and institutions such as savings banks and insurance companies, those who subscribe to the loans put purchasing power in the form of notes or bank deposits at the disposal of the government. As the government spends the amounts borrowed the notes and deposits are again made available to the public, but in the end there is no increase in the note circulation or in the volume of deposits as a result of the government borrowing. On the other hand, if the government borrows from the commercial banks there will be a tendency towards an expansion in the volume of deposits held by the public (as and when the government spends the money)



and there is also likely to be some increase in the amount of notes outstanding (no contraction having been made in the amount of notes and deposits already in the hands of the public). It is true that the increase in deposits may in a measure be offset by businessmen's repayments of loans to the commercial banks. It is, however, a fact that in almost every country the increase in the commercial banks' *lending to the government* (whether in the form of direct advances or discounting of Treasury bills or purchase of bonds) has been accompanied by an expansion in deposits. The questions then arise whether in this way new resources additional to the current savings have been "created" and whether this method of financing is necessarily inflationary in character. No general answer can be given to these questions, as may be seen from an analysis of the different conditions that may obtain.

When employment is rising in a country in line with a natural increase in the working population or from an absorption of unemployed, there should normally be an expansion in the means of circulation to match the enhanced economic activity. The increased holding of cash by the public is then a form of genuine savings, non-inflationary in character. At the beginning of a war when a nation's efforts are being enlisted to improve output there may well be room for such an expansion; Professor A. C. Pigou* states that between August 1939 and August 1940 the "warranted" expansion of money in the United Kingdom amounted to between 5 and 10 per cent. As the war goes on, however, and more men are mobilised and heavier shackles are laid on foreign trade, it is to be expected, on the basis of experience from previous wars, that the volume of production will tend to decline rather than increase, leaving no room for a non-inflationary expansion of circulating media to match increased activity.

The case just mentioned, however, in no way excludes other possibilities of a non-inflationary expansion through borrowing from the commercial banks. These banks act not only as part of the monetary mechanism in that they provide the basis for cheque currency, but also as savings banks through which part of the thrift of the public may be transmitted to industry and trade or to the government. The manner in which such transmission occurs may perhaps best be shown by an example. Suppose that an individual who receives his salary in notes saves Sw.fcs 100 by placing a note of that amount on a savings account with a commercial bank. In this case the liabilities (deposits) and assets (cash in the form of notes) of the bank are immediately increased; if the bank in question now lends Sw.fcs 100 to the government (thus exchanging the notes against a government bond) there can be no doubt that this lending is the counterpart of the genuine savings entrusted to the banking system. If, on the other hand, the individual receives his salary through a transfer to his bank account and saves simply by not drawing on his account, there is no immediate increase in the liabilities and assets of the banking system as a result of his savings. The only way in which the commercial banks can take advantage of the savings which, by the inaction of their customers, have been entrusted to them is by the granting of credit in the form of advances or the purchase of securities; either operation in so far as it involves a net extension of the banks' business leads eventually to an increase in deposits — if not at once, at least when the credit facilities are made use of. Thus the increase in deposits occurs not when the savings are made but when they are given employment by the action of the commercial bank. This technical difference compared with what happens when notes are used does not in any way affect the essential nature of the source of the funds, the banks' lending and investment being in both cases the counterpart of the savings entrusted to them. The banks' action is in fact needed to maintain an even flow of purchasing power, and the expansion in deposits is therefore in this case non-inflationary.

In normal times the amount of genuine savings held in e. g. the English banking system is probably relatively stable, but in times of war the habits of the public may change considerably; in some continental countries, as, e. g., Germany, the absorption of savings through the medium of commercial

* In an article in the "Economic Journal" for December 1940.

banks is undoubtedly of great practical importance. In a country with a highly controlled economy there is clearly an element of compulsion with regard to the way in which savings are left with the banks. When a government spends amounts obtained from the banking system the additional purchasing power put into circulation would normally give rise to increased spending, which would in the first instance eat into the available reserves of commodity stocks and before long increase imports and the price level. Through an judicious system of rationing and strict control of foreign trade and prices these effects can in a large measure be neutralised; sheer inability to buy will, up to a point, force individuals to abstain from spending, i. e. to save. If, moreover, opportunities for private investment are severely limited through a series of restrictions (prohibition against building of houses, etc.), there remains no other outlet for those who receive the additional income than to buy government bonds or to leave their money with some credit institution, which will usually be a bank. The successful working of such a system, under which rationing, so to say, becomes a means of monetary policy, presupposes a strict control of wages, prices and investments and the maintenance of a sufficient balance in production to provide the goods needed for the amount of consumption permitted.

To what extent these conditions are fulfilled in any particular country must always be difficult to determine. No doubt the progressive expansion in the volume of deposits, always available as potential purchasing power, is apt to increase the tension between the demand for and the current supply of goods and forces a greater degree of reliance on the efficiency of the control and the discipline of the general public. In countries in which the "free sector" is still of considerable dimensions (and therefore the purchasing power engendered by government borrowing in commercial banks will not be more or less automatically sterilised through the system in force) continuous additions to the volume of deposits, which may be only partially offset by increased holdings of idle money in the banks, are more likely to provoke an inflationary tendency. In a special report to Congress dated 31st December 1940 the Board of Governors of the Federal Reserve System, the Presidents of the Federal Reserve Banks and the Federal Advisory Council recommended, inter alia, that "the financing of the ordinary requirements of the Government and the extraordinary needs of the defence programme should be accomplished by drawing upon the existing large volume of deposits rather than by creating additional deposits through bank purchases of government securities".

What happens if the credit expansion is of such a nature that an inflationary tendency clearly sets in? It is not, of course, at all easy for the commercial banks to determine to what extent savings are being entrusted to them in the manner described above. If those who save transfer their money from current to savings accounts, that is an indication for the banks, but it is notorious that many people leave savings for years on current account. As a rule there may be a reduction in the rate of turnover on deposits with commercial banks as new savings are made, but in abnormal times even these indications may be less helpful.

When the increase in active purchasing power resulting from government borrowing in the commercial banks leads to a rise in prices, a special kind of "levy" is, so to say, imposed on the people. Those who hold notes and other means of payment will acquire less goods and services when they come to spend their money than they could have done when it was earned by them. Furthermore, wages and salaries have a tendency to lag behind the rise in prices; the consequent change in the distribution of incomes will usually swell the profits of business firms, which are subject to high rates of taxation and a source of considerable savings (by the non-distribution of profits in some cases due to an obligatory limitation of dividends). In these various ways a certain flavour of inflation may ease the task of financing heavy government expenditure (and also facilitate the transfer of labour to new occupations able to offer higher pay). In the United Kingdom, as shown in the table, company profits rose by 9.0 per cent. from 1939 to 1940, but net profits fell by 3.8 per cent., mainly on account of higher taxation and increased writings-off. Should, however, the issue of new money proceed at a rapid pace and the general body of wage-earners succeed in obtaining a speedy readjustment of their incomes, the vicious spiral of rising costs and prices will come into operation and eventually, in a runaway inflation, expose the economic and financial system to almost complete disorganisation. The will to save will then be impaired, for whoever abstains from immediate spending will lose heavily. The amounts collected from direct taxes will cover less and less of the government expenditure since these taxes are levied on incomes earned in an earlier period when the value of money was higher. These and other dangers are well known and constitute imperative reasons against any but the most moderate use of inflationary financing.

Profits of 2,260 companies in the United Kingdom.

In millions of £ sterling	Reports in 1939	Reports in 1940	Percentage change
Total profits	377	411	+ 9.0
Depreciation **	161	203	+ 26.4
Net profits	216	208	— 3.8
Preferred dividend	*	47	—
Ordinary dividend	*	126	—
Added to free reserves	*	35	—

Source: The Economist.
* Not available separately. ** Where separately stated including debenture interest and other charges (as well as taxation).

To avoid inflation at a time of heavy budget deficits it is not enough that there should be a sufficient volume of savings. Steps must also be taken to ensure that the savings are reserved for the needs of the state. One way to achieve this result is to control private investment; in a number of countries such control has been instituted, the construction of houses and other buildings, for instance, being subject to special permits granted only in exceptional cases. The building trade is of particular importance with regard to the employment of savings since it binds much capital and in normal times may absorb one half or more of the annual savings (compare the table for Sweden on page 11). Where no comprehensive control has been imposed the contraction in private investment may in a measure be achieved almost automatically. Since the war began the cost of building has risen practically everywhere (in Switzerland, for instance, by about 20 per cent. up to the end of 1940); difficulties are experienced in procuring the necessary raw materials (in particular iron) and interest rates for new mortgage loans have often stiffened even when the interest for government credit has moved but little. As a result the volume of new private building of dwelling-houses has fallen — in some countries precipitously. In Switzerland it was reduced by one-half between the autumn of 1938 and the autumn of 1940 and in Sweden by over 80 per cent.

As regards the public's employment of their liquid balances, there are strong reasons to guard against the danger that a continuous rise in commodity prices may produce a preference for investment in real assets (houses, shares, etc.) as distinct from money claims. Although it is impossible to prevent a rise in prices by financial measures alone, governments are naturally anxious to choose those methods of borrowing which provide the greatest guarantees against an undue expansion in the volume of monetary purchasing power. Borrowing directly from the central bank is likely to be particularly risky since it adds not only to the volume of money held by the public but also to the liquidity of the whole credit system. Borrowing from the commercial banks increases the volume of deposits held by the public but the effect may be mitigated, as seen above, to the extent that genuine savings are entrusted to the banks. On the other hand, when government bonds are successfully sold to private and institutional investors (and notably insurance companies, investment trusts, savings banks, etc.) there is not only no increase in the amount of money outstanding but funds held by the public are "tied up" and thus prevented from being used for other purposes. Most governments have endeavoured to tap the various sources of genuine savings by the issue of a selection of securities adapted to the needs of different categories of investors, instead of relying mainly on the issue of "big loans", as in 1914–18. Special types of securities continuously available are usually issued for large and small lenders; and variety is also provided with regard to dates of maturity, etc.

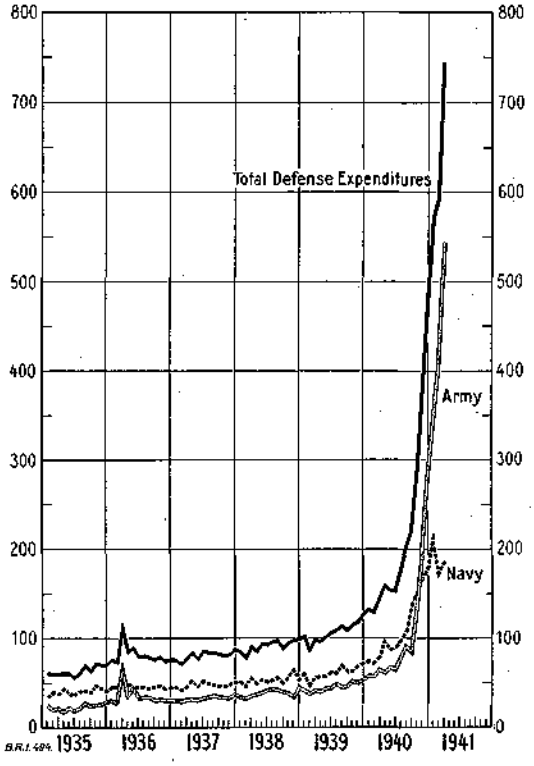
In the issue of long and middle-term loans, the question of the rate of interest to be offered takes a more acute form than in borrowing from commercial banks. The general policy has been to avoid an increase in the interest level in order to enable the governments to borrow at the least possible cost and also to prevent an increase in the interest burden of old debts as, for instance, mortgages. At a time when capital is being diverted from normal investments to armaments, when houses, plants, equipment and inventories can only partially be maintained or replaced, when commodity prices in most countries have been rising, making it more profitable to hold real assets than money claims (provided that the rise in prices becomes permanent), the "natural" tendency is probably for interest rates to stiffen, as in fact has been the case in previous periods of war emergency. This tendency may, at least temporarily, be counteracted by the central and commercial banks, which are able to increase the supply of liquid funds. Whether or not it is desirable in a period of growing scarcity of goods to allow a high degree of liquidity is a question which must be considered in relation to the monetary policy pursued and the extent of the control imposed on each economy.

The rôle of finance in war is primarily to assist in the transfer of resources — man-power, plant and raw materials — to the essential purposes determined by the task of attaining a maximum effort of national strength; and it is because bad financial management — particularly if it leads to wild inflation — is apt to impair this effort that weight must be given to financial as distinct from economic and political considerations. Nevertheless, economic mobilisation must also rely on other forces than those provided by a shift in monetary demand; in the present emergency direct organisation of production, distribution and consumption has been applied on a much wider scale than in 1914–18, as is shown by the many measures of rationing, fixing of prices, export and import regulations, compulsory transfer of labour, control of investments, allocation of raw materials and establishment of priorities. Never before in the modern world has state intervention been pushed so far as at present; and it is also true to say that never before has state direction been so successful.

In Germany the prohibitions originally introduced in 1936 against increases in prices and wages were supplemented at the beginning of 1940 by limitations of profits, and although these provisions are applied with a certain elasticity the result is, as the President of the German Reichsbank (who is also the Minister for National Economy) explained in his speech at the Annual Meeting of the Bank on 12th March 1941, that "prices and wages are no longer an instrument for the direction of production". Instead of waiting for the slow processes of economic pressure, government agencies intervene, particularly in the belligerent countries, to determine the utilisation of productive resources and if need be to concentrate production on the most efficient enterprises and so eliminate waste and ensure the greatest possible results. For instance, in a speech in the House of Commons on 4th March 1941 the President of the Board of Trade announced that the policy of the British Government was "to concentrate production on a reduced number of factories working full time. These factories should be able to produce the output required for government orders, the greatest practicable export trade and the minimum needs of our population, while at the same time preserving the goodwill of the factories closed down" (which under certain group arrangements will receive compensation from the firms able to work at full capacity).

Complete control of a national economy in all its ramifications is, however, difficult to establish; it is indeed probable that in most countries relative changes in prices and remuneration still provide inducement to work

U. S. A. - National Defense Expenditures.
Monthly, in millions of dollars.



and also have their effect on the volume of consumption. Indeed, price control itself must always be applied with a certain elasticity; and in countries not actually engaged in war the "free sector" is still of considerable importance. In the United States, which, with more than 40 per cent. of the world's industrial capacity, is of outstanding importance in the economic life of the world, little compulsory control of an emergency character has been introduced although the country is, of course, affected by the increase in armament expenditure. Expenditure of the present magnitude will undoubtedly produce far-reaching changes in the economic position of the United States and necessitate increased government action exercised through the Advisory Commission to the Council of National Defense and the Office of Production Management, with various attached agencies such as the Priorities Board; but there has been no imposition of new compulsory measures to transfer labour and capital or to prevent increases in wages similar to those adopted in many European countries. In March 1941 the government appointed a Defense Mediation Board to assist in the adjustment of differences between labour and management in the defence production industries. Its intervention is on a voluntary basis. And in April 1941 an Office of Price Administration and Civil Supply was established to counteract price rises, particular emphasis being laid upon the stimulation of increased supplies of materials and commodities. As far as foreign trade is concerned the government has decreed a series of prohibitions against export of essential commodities except under licence and taken steps to procure from abroad stocks of strategic and other important materials; but these measures only indirectly affect the internal economy.

In the United States, as in other countries, rapidly rising defence expenditure means a diversion of resources to production which does not in itself increase the real wealth of the country or improve the standard of living, thus differing from the type of investment activity which characterises the ordinary business boom. Fuller employment and overtime work add, however, to the earnings of labour and business firms, and, in so far as these higher incomes remain unabsorbed by taxation or are not offset by higher savings, they will lead to an enlarged demand for a wide variety of ordinary goods. Thanks to the large domestic production and imports from Latin American countries — themselves in possession of abundant stocks — there should be little difficulty in satisfying an increased demand for food in the United States. The extent to which other products will be available will depend mainly on the possibilities of expansion in different branches of manufacture through a better utilisation of men and material. Between the summer of 1939 and the spring of 1941 total industrial production in the United States had risen by 33 per cent. with a rise of 50 per cent. in durable manufactures (largely armaments) and 17 per cent. in non-durable manufactures (mostly consumption goods). By this increase the volume of production has, in all the main branches, surpassed the high point reached in the summer of 1929.

In an address delivered to the National Industrial Conference Board in New York on 28th November 1940 the Chairman of the Board of Governors of the Federal Reserve System laid great stress on the need of increasing production and especially of solving what he called the "bottleneck" problem which arises from pronounced shortages of skilled labour and specialised machinery. It was, he said, essential to the general welfare that business and labour should avoid strikes and lock-outs, which interrupt the flow of production, and likewise avoid price and wage policies which induce forward buying and inventory bulges due to fears of higher prices; he did not think it possible to overemphasise the evils in the kind of inflation originating in what were essentially monopolistic practices either by capital or by labour; the immediate danger was that the upward spiral of prices in particular sectors of the economy might throw these sectors out of balance with the rest of the economy to the detriment especially of agriculture, unorganised labour and both the low-income and the fixed-income groups.

In pronouncing these warnings there can be little doubt that the authorities in Washington have in mind the lessons of the short-lived boom of 1936–37 when rapid increases in wage rates and undue additions to inventories caused sectional increases in costs and prices out of balance with the all-round expansion in national earnings. So far commodity prices have remained remarkably steady considering the pressure exerted in different directions. One of the reasons for this stability is no doubt the surpluses in a number of basic commodities which, contrary to the experience of the 1914–18 war, have not been in excessive demand from abroad. For farm products the diminution in the export outlets for cotton, tobacco, wheat, meats and fruit was bound to cause difficulties. Apart from government assistance a certain compensation for reduced exports should be found in an increased domestic demand for and a consequent shift of production to dairy and poultry products, meats, wool, fruit and vegetables as the defence programme increases payrolls throughout the country. Moreover, a marked industrial recovery may attract workers from farms and thus reduce the number of people who must find their support in agriculture. Such a transfer of workers from agricultural to industrial pursuits will presumably reduce the intensity of farm production, so that the difficult problem of the depressed state of American agriculture will be at least partially solved on much the same lines as in earlier periods of the history of the United States (as was pointed out by economists attached to the Department of Agriculture in Washington in a statement published in January 1941).

In Europe the degree of agricultural self-sufficiency — so important in wartime — varies greatly from one region to another and no generalised picture can be given. For Great Britain it is literally a question of "import or die" since the country's economy for close on one hundred years has been based largely on the import of foodstuffs against the export of industrial articles. Efforts may be made to increase home production, estimated to meet about one-quarter of food requirements in pre-war 1939, and consumption may be limited by rationing, but complete self-sufficiency with the present population is unattainable. If the Continent of Europe (excluding the British Isles and the U.S.S.R.) be regarded as a whole there was in pre-war 1939 a high degree of self-sufficiency in certain important foodstuffs, cereals, meat and dairy produce, but the distribution of resources between four main groups of countries cannot be disregarded: (i) the natural exporting territories in the Danubian region where, although yields were low, total production, especially of cereals, consistently exceeded domestic requirements; (ii) certain countries, such as Germany, Italy, France and Sweden, which, partly by nature partly by directed effort, were more or less self-sufficient; (iii) the specialised countries, such as Denmark and Holland, which, although food exporters in peacetime, were also dependent on considerable imports and (iv) countries such as Belgium and Norway with a very low degree of self-sufficiency.

Self-Sufficiency in Foodstuffs of European Countries*

in percentage of full self-sufficiency.

Great Britain	25	Italy	95
Norway	43	Spain	99
Switzerland	47	Czecho-Slovakia	100
Belgium	51	Estonia	102
Holland	67	Denmark	103
Eire	75	Poland	105
Austria	75	Yugoslavia	106
Finland	78	Latvia	106
Greece	80	Bulgaria	109
Germany (Old territory)	83	Lithuania	110
France	83	Roumania	110
Sweden	91	Hungary	121
Portugal	94	U. S. S. R.	101

* Taken from a table published by the German Institute for Business Research in February 1939. Consumption in calories for individual countries (generally for 1937) was estimated as well as the proportion of the total which imports provided or exports represented. The extent to which the figures are below 100 indicates the degree of dependence on imports while figures above 100 show a corresponding export surplus of foodstuffs. It should be noted that the estimates are in calories (energy) and thus no account is taken of the desirability of "protective" foods and of a varied diet.

But even in peacetime there were two important exceptions to autarky in foodstuffs: all continental European countries, except the Balkans and Spain, depended to a lesser or greater degree on imported animal feeding stuffs; and, even with normal foreign supplies of fodder, animal fats (butter, lard, etc.) furnished only a part, perhaps one-half, of total requirements in oils and fats. Apart from the southern countries, which produce olive oil, by far the greatest proportion of vegetable oils was imported in the form of soya beans and ground-nuts for crushing and refining.

In 1940 the continental European food situation changed in some important respects. About ten per cent. of the area of Continental Europe, mostly agricultural land, was acquired by the U. S. S. R. (How far this loss may have been offset by increased exports from Russia is difficult to determine in the absence of current statistics.) There was a failure of the wheat harvest in the Danubian area and a drastic decline of cereal exports from this source. The wheat harvest for the total continental European area fell to a level perhaps 20 per cent. below normal requirements, with shortages unevenly distributed. Finally, the numbers of cattle, pigs and poultry were reduced owing to the lack of imported fodder and failure of crops in some areas and to the necessity of using domestic barley and maize for direct human consumption to supplement wheat; as a consequence exports from the principal specialised dairy-produce countries declined in the latter part of the year.

The reduction in the number of animals may be illustrated from statistics published in Denmark (where this development was of particular importance).

Denmark — head of livestock.

Nearest figure to end of quarter in thousands	Cattle	Pigs	Poultry
1939, June	3,271	3,127	32,398
1940, June	3,221	3,218	21,868
1941, March	2,976	1,825	8,055

Pigs and poultry were the first to be sacrificed: they compete directly with human consumption of grain and their numbers may be most easily reconstituted when normal conditions return; moreover, there is an urgent need to keep the number of cows as high as possible in order to maintain the supply of milk, unique and irreplaceable for human consumption, and of butter which, as a fat, is of even greater relative importance than usual. As regards fats in general, mention should also be made of industrial uses, such as the manufacture of soap and of certain explosives, which directly compete with the requirements for human consumption.

Reductions in the output of dairy produce and of eggs mean a shortage of "protective" foods (of which current supplies are indispensable since they are generally perishable and do not easily stock) as contrasted with the calories (energy requirements) needed for human existence.

Although food is rationed more or less severely in all European countries this is not necessarily a sign of immediate shortages since efforts are made to conserve accumulated stocks. Comparison of rations permitted is no sure indication of relative shortages since the importance of substitutes and of unrationed foods must be taken into account as well as differences of habits and of needs in varying climates.

The bad harvest in 1940 was one of the reasons for the rise in wholesale prices and the cost of living which has occurred in most European countries. Already before the war prices of agricultural products were to a large extent fixed by official action; and the increases which have been allowed in 1940 have been made partly for the purpose of compensating farmers for the smaller output and partly to provide a stimulus to higher production. Other important reasons for the rise in prices have been increased transport costs and in many instances also higher prices asked for by the exporting countries as well as the higher cost of domestic production of "substitute goods" when imports of sufficient quantities have no longer been possible. The following table shows the increase in the price level from the first six months of 1939 to December 1940 and, where data are available, the rise in prices during the first year and a half of the 1914–18 war.

Percentage Increases in Wholesale Prices.

Country	January-June 1914 to December 1915	January-June 1939 to December 1940
Germany . . .	+ 53 %	+ 4 %
U. S. A.	+ 9	+ 5
Canada	+ 9*	+ 14
South Africa .	—	+ 16
Hungary	—	+ 27
Bulgaria	—	+ 32
Sweden	+ 50	+ 46
United Kingdom	+ 48	+ 52
Switzerland . .	+ 25*	+ 54
Denmark . . .	+ 49*	+ 74
Yugoslavia . . .	—	+ 86

* Yearly average 1915 compared with 1913.

As a great variance is found in the composition of the price indexes for different countries, a warning must be uttered against hasty comparisons; and this is the more important at present when changes in the qualities of goods are only imperfectly reflected in the calculation of the price changes. A similar reservation applies to comparisons between the movements in 1939–40 and twenty-five years ago. Apart from Germany, it may, however, be said that price developments for the first year and a half of this war are roughly of the same magnitude as those in 1914–15. For goods obtained from abroad it has often been found necessary to pay enhanced prices in order to secure supplies for current consumption and for building up reserve stocks. Foreign trade statistics reveal record imports by many European countries in the autumn and winter of 1939–40; in these countries the rise in the price level was certainly not the result of a greater scarcity of goods. The current income of the great mass of consumers had probably increased but slightly; such compensation as was obtained by wage-earners would seem to have been restricted in most countries to about one-half of the increase in living costs, which in its turn is often found to have been about one-half of the increase in the level of wholesale prices. At the beginning the increase in monetary demand, which forms the counterpart of the rise in prices, was probably sustained mainly by the public drawing on their bank deposits — a form of expansion against which the monetary authorities have hardly any means of action. Later on, government spending of funds borrowed from the central or commercial banks and higher earnings by farmers and other income groups (some of them no doubt with a relatively low velocity of circulation) were in many countries important factors of additional monetary expansion. The dominant position of the governments on the money and capital markets leaves little room for action by central banks to withstand inflationary tendencies. In the past it has often been regarded as a principle of credit policy that the central banks should intervene against the trend in commodity prices: when prices fall a policy of cheap and plentiful credit should be applied and when prices rise an opposite policy should be enforced. In the present situation of rising prices attempts seem to be made not so much to supplement as to replace central-bank action by a far-reaching price and investment control. The question remains, however, whether in this way the interest level and the degree of liquidity can be reduced to relatively insignificant factors in the development. There can in any case be little doubt that the larger the "free sector" is in an economy the more important is the observance of the more traditional credit principles in the struggle against inflation.

In the first years of the war of 1914-18 there was a remarkable degree of correspondence between the movements of commodity prices and exchange rates in conformity with the purchasing power parities of the various currencies. As restrictions became more incisive and transport costs rose to high levels and foreign credits were arranged, this correspondence was disturbed by other more important influences. In the present emergency the interruption of normal trade has been effected more quickly than in the last war. Moreover, systems of exchange control with the fixing of official rates have been so widely put into force that little room has been found for independent market quotations. It is true that "free rates" have been quoted for certain currencies in addition to the official rates, but these "free rates" usually reflect a limited number of transactions and can therefore in no way be regarded as representative of major movements. Alterations in official rates were made during 1940, especially of continental European rates in relation to the Reichsmark. These changes were made in order to relate the currencies in occupied countries to the official rate of the Reichsmark or to establish a more uniform exchange structure in the Danubian and Balkan areas. The working of a multilateral clearing presupposes as an indispensable condition that those countries which participate in the system apply a consistent structure of rates and cross rates. In recent discussions emphasis has increasingly been laid on a number of other conditions which must be fulfilled in order to enable a multilateral clearing to work satisfactorily. One of the Vice-Presidents of the German Reichsbank* underlined the fact that "a sound domestic currency policy in all the countries participating in the clearing must be the foundation of the whole system; since the external value of a currency is always dependent on its internal value, it is in the long run impossible to maintain stable exchange rates when an unsound

* In an article published in "Die Staatsbank" of 10th November 1940.

currency policy at home leads to uncontrolled price increases. The basic rule applies that the monetary circulation must always stand in a well-proportioned relation to the turnover of commodities".

This insistence on the need of fundamental equilibrium, with all that it implies in the way of economic and budgetary policy, holds good for a multilateral clearing as well as for any other international monetary system which is to function without disturbance. After 1918 it proved impossible to re-establish an international standard free from fundamental maladjustments; and this failure, due to a variety of causes, was no doubt largely responsible for the unfortunate monetary and economic developments in the decade from 1929 to 1939. Bitter experience has shown that the principles of monetary equilibrium cannot be disregarded with impunity; and this lesson must be borne in mind when currency relations now deranged by war conditions are established anew on an international basis as a factor in the post-war reconstruction.

II. EXCHANGE RATES, FOREIGN TRADE AND PRICE MOVEMENTS.

1. EXCHANGE RATES.

The main characteristic of foreign exchange conditions in 1940 was a further extension of official regulations, generally combined with detailed supervision of foreign trade. Steps were taken to stop leakages in the existing exchange controls; the remaining markets for "free rates" became narrower as foreign payments — commercial and others — were forced into official channels. Alterations in exchange values were the result not so much of market forces as of deliberate official action, often undertaken in connection with commercial negotiations. In the Danubian and Balkan regions the lack of uniformity in the quotations of different currencies, the result of a complicated system of premiums and varying provisions for surrender of foreign exchange, was largely eliminated. In areas occupied by Germany rates of exchange were fixed more or less in conformity with the official quotations previously in force. In the United Kingdom and other countries of the British Empire the exchange regulations were reinforced and further agreements concluded with foreign exchange centres; as a result the quotation of free sterling, which in May 1940 had fallen 20 per cent. below the official rate, recovered in the autumn the ground which had been lost.

Among developments outside Europe interest attaches to the immobilisation in the United States of the assets of a number of European countries which were occupied in the course of the war or otherwise changed their political status. Fear of an extension of these measures provoked fairly extensive capital movements: some Sw.fcs 850 million were, for instance, sold by private investors to the Swiss National Bank between the middle of June 1940 and the end of March 1941. In Latin American countries export difficulties continue to limit the normal supply of foreign exchange and have necessitated stricter control measures. In a few instances (Bolivia, Peru, Venezuela) they have led to further depreciation. The exchange position of the Argentine, Brazil and Mexico has been strengthened by a considerable influx of money from abroad, partly refugee funds and partly capital for new investments, while a number of Latin American countries were assisted by credits obtained from the Export-Import Bank and the Exchange Stabilization Fund in the United States. Finally, in the Far East the continuation of hostilities has subjected the exchanges to further strain: in the autumn of 1940 a strict control was imposed on the exchange of goods and the transfer of money between the different countries forming the yen area (Japan, Manchukuo and North China); in December 1940 a new central bank was established in Nanking with its own currency, competing in Shanghai and other areas with the Chungking yuan (the currency of the Chiang Kai-Chek Government); the latter, after a depreciation of 25 per cent. in the first four months of 1940, remained relatively stable up to the end of the year. Between the Yokohama Specie Bank and the Bank of Java an agreement, valid for one year but terminable at three months notice, came into force on 1st January 1941, under which these banks make advances in their own currency to ensure prompt payments to exporters, any balance being settled from time to time by payments in U.S. dollars. In several European clearing agreements provisions have also been included for advances by central banks to avoid delay in payments through the clearings — examples of the increased importance of official intervention under conditions which exclude resort to the ordinary sources of banking credit.

The present preponderance of the Reichsmark in the currency structure of the European continent is due to the increased relative importance of the German market for the trade of many countries after the cutting-off of their overseas commercial relations. In the area within the German barrier more than one-half of the foreign trade is with Germany and practically all payments are made through clearings. Steps have been taken in Berlin to facilitate transactions by a development towards a multilateral clearing system. In this connection the arrangements entered into with countries in the Danubian and Balkan regions are of particular interest.

Especially after 1933 the intensification of trade relations with countries in central and south-eastern Europe became an objective of German commercial policy, partly because these countries could deliver agricultural and other primary products in exchange for industrial articles and partly because trade with these areas could presumably be maintained even in the event of a war. Since the world-wide depression made it difficult for the Danubian and Balkan countries to sell their agricultural products in western Europe, these countries were naturally interested in the possibilities of exporting at comparatively remunerative prices to the German market. In their clearing agreements with Germany the old par rates of exchange were at first applied. It was soon found that exports to Germany tended to exceed imports, leaving the countries from time to time with a credit balance which in some instances affected the rates of the Reichsmark quoted in the free market. Since the Danubian and Balkan countries were in need of free "devisen" to pay for their imports of overseas raw materials (textiles, colonial products, etc.) and to meet the service of their foreign debts, they allowed premiums on the purchase and sale of free exchange in order to stimulate exports payable in such exchange. In that way the rates applied to such currencies as dollars, sterling and Swiss francs did not correspond to the rates applied to the Reichsmark; and between the different countries in the Danubian and Balkan regions a variety of clearing rates were in force, with cross rates that did not harmonise.

After the war had started in 1939 a series of developments set in which affected the exchange situation. Trade with most of the so-called free-exchange countries became gradually more difficult; commodity prices were rising in the Danubian and Balkan regions; the harvest in 1940 was generally a poor one and, for other reasons also, exports to Germany tended to decline. On the other hand, imports from Germany were badly needed; within a short time the clearing balances began to move in favour of

Germany. By negotiations which were pursued in the latter half of 1940 new arrangements affecting the exchange rates were entered into between Germany, on the one hand, and Bulgaria, Greece, Hungary, Roumania and Yugoslavia individually, on the other.

The following table summarises the results of these negotiations:

Dollar and Reichsmark rates of Danubian and Balkan currencies.

Countries	Average rates* on 1st July 1940			Average rates* on 1st April 1941		
	Rate for one dollar	Rate for one RM	Discount of RM in relation to dollar	Rate for one dollar	Rate for one RM	Discount of RM in relation to dollar
			Percentage			Percentage
Bulgaria	Lev. 112.05	Lev. 32.75	26.9	Lev. 102.34	Lev. 32.75	20.0
Greece	Dr. 151.25	Dr. 46.50	23.0	Dr. 151.25	Dr. 48.50	19.8
Hungary	P. 5.24	P. 1.62	22.8	P. 5.13	P. 1.66	19.2
Roumania	Lei 214.81	Lei 49.50	42.4	Lei 191.30	Lei 59.50	22.2
Yugoslavia	Din. 55.00	Din. 14.80	32.7	Din. 55.00	Din. 17.82	19.0

* Averages between the rates for sale and purchase including premiums.

As will be seen from the last column of the above table, the valuation of the Reichsmark is now at a uniform level in relation to the gold (or dollar) value of the various currencies in the Danubian and Balkan regions. This result was arrived at in different ways:

(i) In Bulgaria the quotation for the Reichsmark was maintained at the old rate of Leva 32.50–33.00 which had been in force since an agreement of 30th September 1932; but the premium allowed on free currencies was reduced to a maximum of 25 per cent. instead of 35 per cent. as previously. It is of interest to add that the National Bank of Bulgaria agreed to acquire in full the amounts due to Bulgarian exporters in the clearing with Germany.

(ii) In Yugoslavia, on the other hand, the rate for free currencies was maintained unaltered but the rate for the Reichsmark was increased from Din. 14.80 to 17.82. In respect of clearing balances in Reichsmarks already acquired by Yugoslavia it was decided that the old rate should be applied up to two-thirds of the amount involved, so that the Yugoslav exporters would receive a rate of Din. 15.80 for claims already established.

(iii) In Greece likewise the rate for free currencies was left unaltered but the rate for the Reichsmark was increased from Dr. 46–47 to 48–49.

(iv) In Hungary and Roumania a mixed method was used to establish the desired relationship; on the one hand, the rates for free currencies were reduced and, on the other, the rate for the Reichsmark was increased. Thus in Hungary the dollar rate was lowered from P. 5.24 to 5.13 and the Reichsmark rate increased from P. 1.62 to 1.66; in Roumania the premium on the official dollar quotation was reduced from 107 to 90 per cent. and the Reichsmark rate increased from 49.5 to 59.5. In this way the adjustment was made with relatively slight changes in the quotations. A moderate appreciation of the national currencies in terms of dollars and sterling was no longer a matter of importance since trade with the United States, the United Kingdom and other overseas countries had practically ceased; and in relation to Switzerland the possibilities of delivering the goods in demand were found to be more decisive for the maintenance of trade than slight changes in prices or rates. It should be added that for deliveries of petrol by Roumania the rate of Lei 49 was to continue to apply even after 1st April 1941.

To what extent the changes thus introduced into the relationship between the Reichsmark and the currencies of the Danubian and Balkan countries corresponded to changes in the respective price levels is a question difficult to answer since the indexes of wholesale prices or cost of living do not adequately reflect the prices of goods entering into foreign trade. For two countries — Bulgaria and Yugoslavia — indexes of import and export prices are available and show the following developments.

Indexes of Import and Export Prices.

Indexes 1926 = 100	Bulgaria		Yugoslavia	
	Imports	Exports	Imports	Exports
1937	87	84	74	73
1938	80	100	71	76
1939	81	110	80	77
1940 November.	127	126	128	136
December.	128	127	137	142
1941 January .	130	118	139	151
February .	130	113	142	157

The figures reveal a steep rise in both import and export prices since the beginning of the war. For Bulgaria the favourable terms of trade obtained in the years 1938 and 1939 were lost by the end of 1940 when the price relationship was curiously similar to that of the basic year 1926. Yugoslavia, on the other hand, would appear to have profited from the strong foreign demand, at higher prices, for metals, ores and some agricultural products. It would seem to have been a general feature of European price changes in 1940 that the prices of goods entering into foreign trade have risen more than those of domestic products, which are as a rule more strictly controlled. By this divergence the usual calculations of "purchasing power parities" on the basis of wholesale prices are naturally robbed of much of their significance.

In the areas occupied by Germany measures have been taken to determine the rate of the respective currencies in relation to the official quotation of the Reichsmark. In March 1939, when the rate between the Czecho-Slovak crown and the Reichsmark was fixed at K. 10 = RM 1 (instead of the previous quotation of K. 11.62 = RM 1), it was decided to allow the crown to retain the old rates in relation to other foreign currencies (on the basis of K. 11.73 = RM 1) in order not to hamper exports from the Protectorate of Bohemia and Moravia. This meant, for instance, that the dollar continued to be quoted at K. 29.25, instead of K. 25, as would have been the case if the dollar rate were calculated via the Reichsmark. After eighteen months, however, this disparity was ended upon the abolition of the customs frontier between Germany and the Protectorate as from 1st October 1940: in relation to other currencies than the Reichsmark the exchange value of the Protectorate currency was raised by 17 per cent. Since the spring of 1939 commodity prices had risen in Bohemia and Moravia (prices of industrial articles by not less than 41.7 per cent. between March 1939 and July 1940). Such an increase would ordinarily have made an appreciation in the value of the currency difficult to sustain; prices of export goods in the Danubian and Balkan regions had, however, risen substantially since the war began (compare the indexes quoted above for Bulgaria and Yugoslavia).

Of some interest is the special relationship of Bohemia and Moravia to Slovakia. Up to the end of September 1940 one Protectorate crown was exchanged for one Slovak crown (K. 1 = Ks. 1). From 1st October 1940 the exchange was altered to K. 10 = Ks. 11.62. In order to keep trade on the old basis the Slovak Government imposed a levy of 16 per cent. (later reduced to 6 per cent.) on exports to the Protectorate and, from the funds thus obtained, granted subsidies to Slovak importers of goods from the Protectorate.

In the territories of Poland which were incorporated into Germany, as also in the Governor-Generalship, the rate of conversion between the Reichsmark and the zloty was fixed at RM 1 = Zl. 2. On 8th April 1940 the "Reichskreditkassen", opened at the time of the occupation to provide means of payment for the German troops and emergency currency and credit facilities, were closed and a new Bank of Issue for the Governor-Generalship with its head office in Cracow began operations, the old notes of the Bank Polski being exchanged for the notes of the new bank at par. The offices of the Reichskreditkassen were taken over as branches of the new bank; the Reichskreditkassenscheine (the amount of which did not exceed RM 45 million) were withdrawn and replaced by zloty (or by Reichsbank notes in the incorporated territories). German currency is no longer legal tender in the Governor-Generalship, which is connected with the German monetary system through a clearing arrangement.

The rates fixed for the territories occupied by Germany in the spring and summer of 1940 may be seen from the following table:

Rate in national currency for RM 1		Rates of 9th May 1940 Berlin T. T.	Rates for Reichskredit-kassenscheine	Rates of 1st April 1941 Berlin T. T.
Norway	in crowns	1.76	1.67 (1)	1.76
Denmark	in crowns	2.07	2.00 (1)	2.07
Holland	in florins	0.75	0.67 0.75 (2)	0.75
Belgium	in belgas	2.39	2.00 2.50 (3)	2.50
Luxemburg . . .	in Luxemburg francs .	9.57	8.00 10.00 (5)	10.00 (4)
France	in francs	17.84	20.00	20.00

(1) Rates first fixed; afterwards the rates were adapted to the official rates in Berlin.
(2) Altered to this rate on 17th July 1940 and slightly readjusted on 23rd April 1941.
(3) Rates altered on 22nd July 1940 to the rate of conversion fixed in the German-Belgian payments agreement of 10th July 1940. (4) Last rate quoted on 5th March 1941.
(5) Altered to this rate on 22nd July 1940 in accordance with new Belgian rate.

To provide the German troops with means of payment the method of issuing Reichsmark notes called Reichskreditkassenscheine was again employed in Norway, Denmark, Holland, Belgium, Luxemburg and France. Thus the experience gained in Poland was used in the North and the West. Reichskreditkassenscheine became the cash of the German troops abroad, and their import or use in Germany itself was forbidden. In fact, exchange restrictions were imposed between Germany and the German army in foreign countries in order to ensure that the issue of Reichskreditkassenscheine involved no danger to the stability of the Reichsmark. In fact, the employment of Reichskreditkassenscheine as an ad hoc currency made it possible to avoid the issue of Reichsmark notes, which would at least temporarily have swollen the note circulation of the Reichsbank. Under a decree of 3rd May, modified by a decree of 15th May 1940, the central management of the Reichskreditkassen was authorised to issue Reichskreditkassenscheine in denominations of 50, 20, 5, 2 and 1 Reichsmark as well as 50 Reichspfennige and coins of 10 and 5 Reichspfennige against cover chiefly in the form of loans to the Reich, for which a maximum of RM 3 milliard was fixed. Total issues do not seem to have exceeded RM 1.7 milliard and it was semi-officially stated in January 1941 that the circulation of Reichskreditkassenscheine had declined by one-half since the autumn of 1940. The issue of coins has not been of any practical importance. While Reichskreditkassenscheine were issued to the German troops in Norway and Denmark and these notes were given the quality of legal tender, no Reichskreditkassen were actually opened in these two countries since in them the credit systems continued to function with only slight interruption, and early arrangements were made with the central banks for Reichskreditkassenscheine already issued to be exchanged and for the occupying authorities to be supplied with the necessary means of payment against crediting of Reichsmarks to the accounts of these countries with the Reichsbank. For practical reasons the exchange rates of the Reichskreditkassenscheine were at first fixed at 50 Reichspfennige for 1 Danish crown and 60 Reichspfennige for 1 Norwegian crown, but later on the ordinary quotations of the exchange markets were applied, as shown in the above table.

In Holland, Belgium and France Reichskreditkassen were opened in May 1940 by the German authorities, but in each of these countries arrangements were soon made to provide the German troops with the national currency. In Holland the Reichskreditkassen were closed by the middle of July, with the exception of the office in Amsterdam, which was retained for the task of liquidation and liaison. In Belgium the conditions were more complicated since in May 1940 the direction of National Bank of Belgium had moved abroad; a new Bank of Issue was established, which came into being on 15th July 1940. Since, however, the direction of the National Bank at that time returned to Brussels, it was decided that the new Bank of Issue should employ the administration and the notes of the National Bank, the two institutions being under the same management and staffed by the same personnel. The Reichskreditkassen were maintained as credit institutions for the German military administration but the issue of new Reichskreditkassenscheine was on a very limited scale. In France the activity of the Reichskreditkassen was likewise restricted upon the conclusion of an agreement with the Bank of France after the armistice of 22nd June 1940.

In Holland exchange restrictions had been introduced on 10th May 1940, and on 24th June 1940 a comprehensive system of exchange control was imposed according to the German model. Private holdings of gold and foreign exchange were to be offered to the Nederlandsche Bank, which by the end of November 1940 had acquired Fl. 38 million in gold from private hoards. In relation to Germany the exchange restrictions were gradually made less rigid. From 1st November 1940 permission was given to transfer freely an amount of RM 5,000 per month per person; in the early months of 1941 increased capital transfers were permitted but a special tax of 70 per cent. on immediate repatriations of capital was imposed to check a too voluminous inward movement of funds. Then, from 1st April 1941, full freedom of payments was established between Holland and Germany, including the right to bring notes and other means of payment from one country to the other. The Dutch-German clearing ceased to operate as far as payments between the two countries were concerned but remained in force with regard to payments between Holland and third countries. The rate of Fl. 100 = RM 132.70 was made applicable also to notes and coins, which are exchangeable at the offices of the central banks and a number of other institutions. The freedom from restrictions extends to the transfer of capital, but the "blocked mark tax" which had been imposed by the Dutch Government on repatriations of capital investments in Germany was maintained, though with certain alleviations. This tax, which is intended to compensate for the gain accruing to individual owners from the return of capital invested in Germany and to prevent a sudden and wholesale liquidation of such investments, was fixed as follows:

for transfers up to the end of	1941:	at 60	per cent.
do.	1942:	at 40	do.
do.	1943:	at 20	do.

with no tax for transfers from 1st January 1944.

In Belgium a clearing arrangement of 10th July 1940 replaced the previous payments agreement between Belgium and Germany. The new Bank of Issue, which acts as payments institution, has obtained from the Belgian Ministry of Finance a guarantee to the amount of B.fcs 1,000 million in order to be in a position to pay promptly clearing claims of Belgian exporters to Germany.

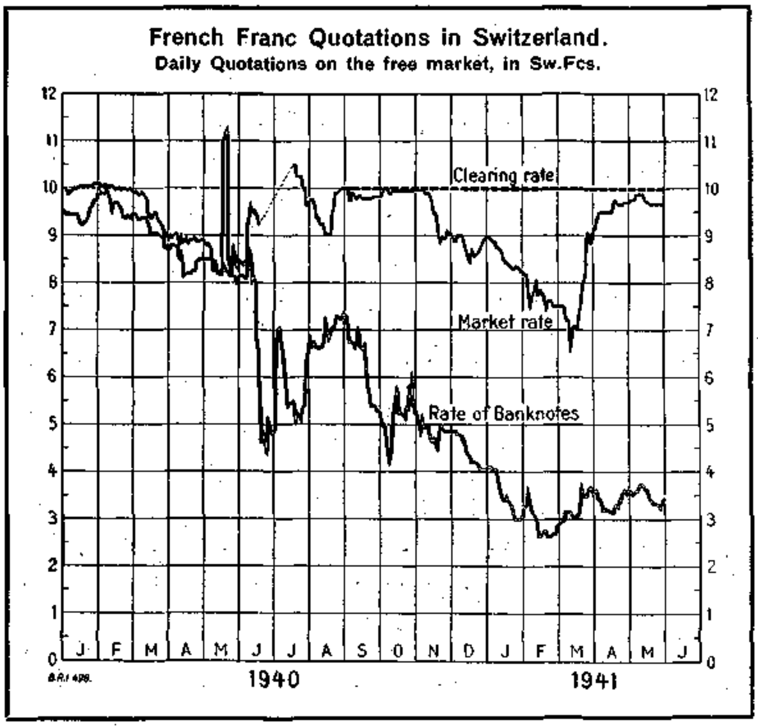
In France the following rates govern the exchange value of the French franc:

(i) In relation to Germany the rate of RM 5 = Fr.fcs 100 (RM 1 = Fr.fcs 20) was originally fixed by the occupying authorities as the rate for the Reichskreditkassenscheine; it was afterwards maintained in the clearing arrangement concluded in the middle of November 1940 between the Reich (including Bohemia and Moravia), on the one hand, and the occupied and unoccupied parts of France as well as the French colonies, protectorates and mandated territories, on the other. While in May 1940 a Treasury Agreement had been concluded between France and Belgium at a rate of Fr.fcs 147.20 = B.fcs 100, it was decided in December 1940 that settlements between France and Belgium should in future pass through a clearing account in Berlin at the rate of Fr.fcs 160 = B.fcs 100, corresponding to the relation of Fr.fcs 20 = RM 1 = B.fcs 12.50.

(ii) After the armistice the agreements concluded in September 1939, by which the rate of Fr.fcs 176.625 = £1 was to be maintained with sterling, lapsed, but the corresponding rate of Fr.fcs 43.80 = $1, was maintained. This dollar rate corresponds to the former rates of Fr.fcs 17.51 for the Reichsmark and about Fr.fcs 10.15 for the Swiss franc.

(iii) In the clearing agreement concluded between France and Switzerland on 23rd October 1940, however, the rate to be applied to all commercial payments was rounded off to Fr.fcs 10 = Sw.fcs 1. For reasons of convenience, this rate was subsequently adopted by the French Exchange Office for all transactions (commercial and non-commercial) which are made neither in dollars nor in Reichsmarks nor via the Reichsmark. These rates correspond theoretically (no arbitrage being possible) to a rate of Fr.fcs 43.11 for the dollar and Fr.fcs 17.25 for the Reichsmark.

(iv) In addition, there is a "free rate" quoted outside France (in Zurich at the present time) for bank transfers on "foreign accounts" opened with French banks in the name of persons residing abroad. These transfers (which are in order from the standpoint of the French exchange control) were disturbed in the autumn of 1940 when, with the blocking of assets and the introduction of a compulsory clearing, the demand for francs on the Zurich market fell off, while the supply continued to be fed by holders of francs living in all the countries cut off from commercial relations with France. Consequently, the rates were temporarily subjected to



The reimport of bank-notes being strictly limited, the market is very narrow and the rate is given only by way of indication.

a downward pressure. To remedy this, the French Government, adopting measures similar to those applied in other countries, made an agreement with the Swiss authorities to limit the transactions in "free" French francs on the Swiss exchange market to persons residing in Switzerland. These measures led to an immediate improvement of the free franc rates in Zurich, quotations approaching the official rate of Fr.fcs 10 = Sw.fcs 1.

(v) Another rate, subject to considerable fluctuation, is quoted for French bank-notes, as in the case of other countries which have prohibited or limited the reimportation of their notes. It is not permissible to take more than Fr.fcs 1000 into France on each journey.

In actual practice the situation is, however, less complicated than might appear from the different rates indicated above. Commercial transactions take place either against or via the Reichsmark at the rate of Fr.fcs 20 = RM 1 or against the Swiss franc at the rate of Fr.fcs 10 = Sw.fcs 1 (corresponding to Fr.fcs 17.25 = RM 1).

By force of circumstances, foreign exchange control was introduced in France in September 1939 when (in contrast to what happened in most countries of Continental Europe) the franc had already undergone a substantial depreciation, namely in the spring of 1938 when the rate for sterling was established in the neighbourhood of Fr.fcs 175. When war broke out, French prices were still below the level of world prices in free currencies and appreciably below those in European countries with exchange control. Subsequently prices rose in France, especially after the armistice, but the rise has been very unequal and, in particular, French agricultural prices have remained (in some cases 50 per cent.) below the prices prevailing in neighbouring countries (calculated according to the official exchange rates). These disparities naturally give rise to problems which are of fundamental importance for the structure of the French economy and which, in present circumstances, are extremely difficult to solve, especially when account is taken of the desirability of avoiding anything liable to prejudice the resumption of more extensive commercial relations when circumstances permit.

The districts Eupen, Malmedy, and Moresnet were included in the German currency system by a decree of 6th June 1940, the relevant rate of exchange being fixed at B.fcs 10 = RM 1, i. e. the rate originally applied to the Reichskreditkassenscheine in Belgium. In Luxemburg the Reichsmark was made legal tender by the side of the old currencies (the Belgian franc and the Luxemburg franc) by a decree of 26th August 1940, which fixed the rate of Lux.fcs 10 = RM 1. From 29th January 1941 the Reichsmark alone was made legal tender, Luxemburg being included in the German currency system. Lorraine and Alsace were at first subject to the monetary arrangements made with France, but on 9th August 1940 the Reichsmark was made legal tender in these provinces together with the French franc at the rate of Fr.fcs 20 = RM 1. In March 1941 the Reichsmark alone was declared legal tender and the two provinces were incorporated into the German currency system. To adjust the level of purchasing power to that of Germany, wages and salaries were in general increased and commodity prices were allowed to rise in sympathy with the increase in costs; rents for houses and land were raised by about 50 per cent.

The clearing arrangements entered into by the Governor-Generalship of Poland, Norway, Holland and Belgium provide for payments through accounts kept at the German Clearing Institute (Verrechnungskasse) in Berlin; and these provisions apply both to the clearings between these four countries in their relations with each other and to the clearings between any one of them and other countries in Europe. In fact the German Clearing Institute enters as creditor and debtor in relation to the clearing institutes of the countries concerned. The centralisation of the accounts for these four countries makes it possible to arrange more easily for a settlement of balances on a multilateral basis. In practice permission must be obtained for a surplus balance on one account to be utilised for payments on some other account and, generally, the total of the amount which any one of these countries can utilise, is fixed in advance for a certain period, usually in connection with commercial agreements.

Between other countries in Europe than the four just mentioned direct clearings are in force without, as a rule, any provisions for settlement of balances in relation to third countries. Since, however, Germany holds a predominant position in the trade of the continent of Europe, the accounts with Germany may afford the possibility of arranging for settlements between a *surplus on one account and a deficit on another; or Germany may*, within limits, allow a surplus in Reichsmarks to be utilised for payments to third countries (as in the German-Bulgarian clearing). In the bilateral arrangements which are being negotiated increased attention is given to the possibilities of settlement in relation to third parties.

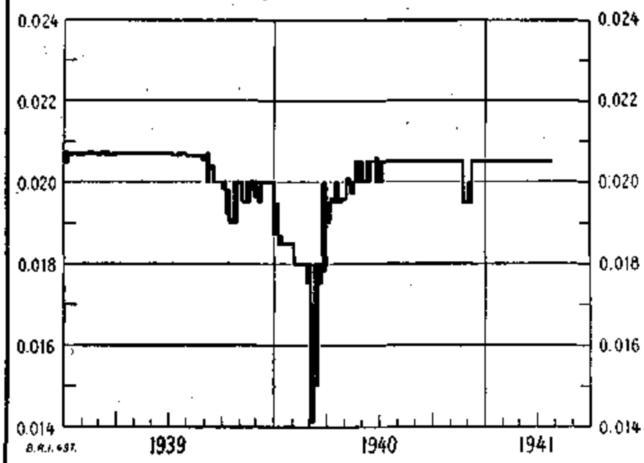
The official rate of the Lira, which had been reduced in September 1939 by about 4 per cent. from \$5.26¼ to \$5.05 = Lit. 100, has been maintained at the latter rate except for a temporary deviation to \$5.032 in the middle of 1940, but at the end of May 1941 it was raised again to \$5.26¼. This raising of the lira rate on the dollar was followed by corresponding adjustments in the rates of a number of other currencies (including the Reichsmark, the Swiss franc and the Swedish crown), the result being a greater uniformity in the system of rates and cross rates in relation to the lira and thus also in the Continental exchange relations generally. Since May 1940 the ordinary "tourist lira" has been allowed only against the U.S. dollar (at the rate of \$4.22 = Lit. 100), the Argentine peso and the Uruguayan peso. Under the Italian-Swiss Financial Agreements of 22nd June 1940 a "mixed lira" was instituted to ease the transfer of Swiss financial claims; the quotation of this type of lira, which under certain conditions may freely be used for a large number of purposes, e. g. tourist expenses, stood at about Sw.fcs 17 = Lit. 100, i. e. some 20 per cent. below the official rate. Special accounts for the requirements of tourists and other personal expenses are also maintained in relation to Germany. On the other hand, a number of special accounts in the clearing between Germany and Italy were abolished in the negotiations in February 1941. Payments between Italy and Albania, on the one hand, and Norway, Belgium and Holland, on the other, for transfer of interest, dividends and rents, amounts paid for personal maintenance, as well as certain commercial payments, were in future to be paid through the general lira and Reichsmark accounts; and the same applies in a large measure to payments in relation to the Governor-Generalship of Poland. At the same time it was decided that Italian workers in Germany could transfer the whole of their savings at the official rate of Lit. 7.63 = RM 1 instead of only the countervalue of RM 88 per month as previously.

After the cessation of actual warfare in the Balkans in May 1941, the Province of Ljubljana and the Governorship of Dalmatia were incorporated into Italy and, after a temporary rate of Din. 100 = Lit. 30, the rate of conversion was fixed at Din. 100 = Lit. 38. In the newly-formed State of Croatia a new monetary unit called the "kuna" was introduced and pegged to the lira at the rate of Kunas 100 = Lit. 38 fixed by a provisional agreement. All payments between Croatia and Italy are made through a clearing. In the Greek territories occupied by Italian troops the rate of exchange has been fixed at Dr. 100 = Lit. 12.50.

With the incorporation in the U. S. S. R. of the three Baltic states in the summer of 1940 the independent existence of the currencies of these states had gradually come to an end. The Council of the People's Commissars in Moscow decided that as from 25th November 1940 the rouble would circulate in the territories of these three countries concurrently with their own currencies, the rates of conversion being fixed at Rouble 1 = E.Kr. 0.80, Lat. 1 and Litas 1.11. At the beginning of April 1941 it was further announced that the Council of the People's Commissars had decided to abolish the three currencies. Under Soviet legislation the rouble may not be used for foreign payments and the export of rouble notes is prohibited, conversion into foreign currencies being made only by the Soviet authorities. The introduction of the rouble led to a marked increase in prices in the Baltic countries.

Notwithstanding the war between Finland and the U. S. S. R. the exchange value of the Finnish mark (FM 1 = 20.3 U.S. cents) has been maintained with regard to the "free" mark created under the Finnish exchange regulations introduced in October 1939. The market in this type of marks has, however, been narrow. Simultaneously with the creation of the "free" mark a new type of mark was introduced, viz. "internal marks", which to begin with showed considerable fluctuations in the rate of exchange, touching a quotation of S.Kr. 6 for FM 100 in 1940 (corresponding to a rate of FM 1 = 14.3 U.S. cents). An effective difference between free accounts and internal accounts seems to have been established in May 1940. From September 1940 the rate for internal marks was stabilised around S.Kr.7–7.50 (corresponding to a rate of FM 1 = 16.5–17.8 U.S. cents).

Finnish Mark Exchange in New York.
Weekly Range of High and Low Quotations, in dollars.



The internal marks are available only for certain purposes and may not be employed for payment of Finnish exports (most commercial payments are made through clearings at official rates). In November 1940 the export of bank-notes was forbidden. All holdings of foreign exchange must now be remitted to the Bank of Finland, whereas previously the owner of such exchange was allowed to retain the countervalue of FM 5,000. The import into Finland of Finnish bank-notes is not prohibited.

The exchange restrictions which had been introduced in Sweden during February 1940 were at first designed mainly to control capital movements but, as conditions turned more difficult in the spring, they were also used as a means of import control. Later in the year, when the exchange market became easier, it was possible somewhat to soften the restrictions. While in the first four months of 1940 the combined holdings of gold and foreign exchange of the Riksbank and the commercial banks fell by about S.Kr. 320 million (mainly because of payments for excess imports), the movement for the remainder of the year was in the opposite direction, the combined holdings rising by about S.Kr. 120 million. In this latter period from May to December 1940 the Riksbank acquired S.Kr. 255 million of foreign exchange, while the commercial banks reduced their holdings by S.Kr. 133 million. This reduction, which was most marked in the late autumn, would seem to have been due to fears that sales of Swedish assets in the United States would be made subject to licence and possibly also that the Swedish crown would be raised in value in relation to the dollar. During the year there was, however, very little change in the quotations for any of the leading currencies. After the conclusion of the Commerce and Payments Treaty between Sweden and the U. S. S. R. in September 1940 a clearing rate of S.Kr. 79.18 = Roubles 100 was fixed.

The year 1940 in Switzerland was characterised by unusually strong movements on the foreign exchange market. During the first five and a half months the National Bank, together with the Exchange Equalisation Fund, furnished the market with dollars to an equivalent of nearly Sw.fcs 500 million. In the main these dollars were required to pay for a heavy excess of imports and to supply the means of payment for future imports, but in part they served to meet withdrawals of funds owned by foreigners and, as the political situation became more unfavourable, to provide for the acquisition of dollar holdings on private account.

In the middle of June, when France opened negotiations with Germany for an armistice, funds suddenly began to return to the Swiss market and the inward movement continued almost without interruption up to the end of the year, by which time the National Bank had added nearly Sw.fcs 650 million to its foreign exchange holdings. At first this movement was due principally to the sale of dollars by commercial and industrial firms which no longer needed that currency for payments abroad since imports from overseas countries had been largely cut off. Towards the end of the year there was another and more important reason for the massive repatriation of funds, viz. the fear that Swiss assets in the United States would be placed under the régime of licences by the American Government. In the first quarter of 1941 dollar funds still continued to be liquidated, the National Bank acquiring the countervalue of about Sw.fcs 200 million.

When the National Bank had to provide dollars for the market in the spring of 1940, the question arose whether or not exchange restrictions should be imposed. The authorities decided against such a measure, seeking a solution on other lines. In order to prevent an undesirable outflow of funds the National Bank, in agreement with the Federal Department for Finance and Customs, asked the banks on 10th May 1940 to limit their supplies of foreign exchange for industry and trade to the amounts needed for payments of imports and foreign services, and in particular to abstain from the sale of exchange for foreign investments. Thus, an informal arrangement between the National Bank and the other banks took the place of official restrictions. When later on in the year the National Bank had to acquire large amounts of dollars, it adopted the policy of demanding information as to the origin of the foreign exchange offered to it. The Bank was not interested in receiving unstable foreign funds and it was anxious to prevent blocked dollars from being liquidated through the Swiss market but it accepted all the exchange resulting from Swiss exports or representing repatriation of funds in Swiss ownership. Notwithstanding the large increase in the National Bank's exchange holdings the arrangement limiting the outflow of funds was maintained in order to keep the country's capital at the service of the Swiss economy. The informal way in which contact — mostly by telephonic communication — is maintained between the National Bank and the other banks makes it easy to apply the principle agreed upon with all the desirable flexibility. Payments in connection with commercial transactions and remittances of dividends, interest and amortisation are free from all other restrictions than those inherent in the working of clearing arrangements or laid down in the Federal decree of 6th July 1940, under which payments to creditors domiciled in Belgium, France, Luxemburg, Holland, Denmark and Norway must be made to the National Bank. The same decree also places certain limitations upon the right to dispose of assets held or managed in Switzerland for persons or firms domiciled in these six countries.

In the first five and a half months of the year the dollar rate remained unchanged at Sw.fcs 4.45⅞ = $1. In response to the subsequent inflow of funds the rate gradually went to Sw.fcs 4.30⅞, where it was held from October 1940 to April 1941 except for some minor fluctuations in the last two months of 1940. The improvement in the dollar value of the Swiss franc affected the quotations of other currencies also; the rate fixed in the Swiss-German clearing was reduced in October 1940 from Sw.fcs 175.44 to 173.01 = RM 100. On the other hand, the National Bank has kept its purchase price of gold unaltered at Sw.fcs 4,869.8 per kg. and has bought gold at that price from foreign central banks and whenever the francs paid for the gold were to be used for settlement of commercial and other operations useful to the country.

The rate of exchange of the dollar in Spain, which had been raised from Pesetas 9.00 to Pesetas 9.90 = $1 in September 1939, moved slowly upwards from December 1939 to April 1940, when the dollar selling rate was pegged at Pesetas 11.22. Arrangements having been made with the United Kingdom for the opening of special accounts for Spain, the free market quotation for the peseta was discontinued in London as from 9th December 1940 and replaced by the Bank of England clearing rates: an official rate of Pesetas at 40.50 = £1 and a so-called "voluntary rate" of 46.55. The former rate is applied to commercial transactions and the latter to charitable and family remittances.

The foreign exchange regulations in Portugal, which may be traced back to measures taken in 1914, were abolished in October 1937, since when the exchange market has been free from official restrictions. From 1932 to 13th November 1939 the escudo was pegged to the pound sterling at the rate of Esc. 110 = £1. On 14th November 1939 the escudo was related to the dollar at the maximum rate of Esc. 27.50 = $1, while the rate for the pound was fixed at Esc. 108.25 = £1, but with certain supplementary provisions designed to attenuate the depreciation of the escudo in the event of a fall in the quotation of free sterling on the New York market. In the following months the exchange value of the escudo moved between the value of free sterling and the dollar. When the free sterling rate recovered in the summer the escudo was pegged to the pound as from 1st August at a rate of Esc. 99.50–100.50 = £1, which corresponds to a dollar quotation of about Esc. 25 = $1. The exchange market is free from official restrictions but the Bank of Portugal maintains contact with the commercial banks to ensure collaboration with the general aims of the Bank's monetary policy.

In the United Kingdom the system of exchange control, introduced by an order of 25th August 1939, has been made more watertight and homogeneous through a series of measures taken in the course of 1940, and at the same time has moved towards a strict sectionalisation of the exchange market. Under the original provisions foreign owners of bank balances in sterling were in a large measure able to dispose of them in "free markets" and the "free sterling" which the purchasers acquired could be used to pay for such British-area exports as did not fall under particular clearings and payments agreements (notably exports to the United States and Switzerland) and for some other purposes. When British exports were paid for with sterling bought in the free markets no foreign assets accrued to the British Exchange Control. In March 1940, however, it was made compulsory for exporters of whisky, furs, tin, rubber, jute and jute manufactures from the controlled sterling area to insist on being paid either in foreign currency or in sterling bought at the official rate. And on 8th June 1940 it was decided to block sterling securities held by non-resident investors and further to require payments for all British exports to the United States and Switzerland in sterling obtained at the official rate or in dollars or Swiss francs. Foreign holdings of sterling, i. e. bank balances in the United Kingdom not specially designated under any of the bilateral agreements concluded, are still free, but the new measure limits or prevents their replenishment and the use which can be made of them for the payment of sterling-area exports.

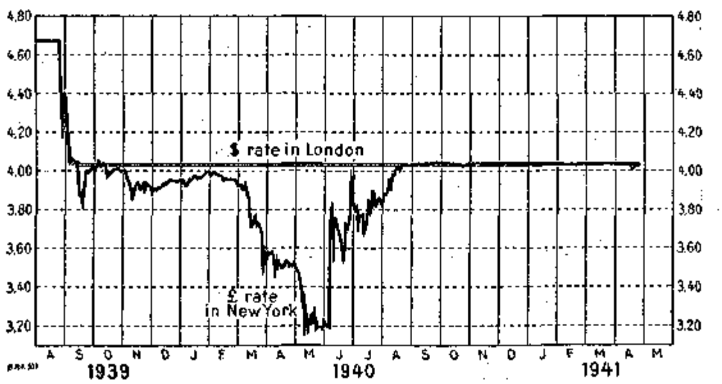
Transfers of funds may be freely made between the United Kingdom and any of its colonies, protectorates and mandated territories with the exception of Canada, Newfoundland and Hong Kong. It has been estimated that since the beginning of the war the tendency has been for net payments from the United Kingdom to other members of the sterling area to amount to about £150 million a year, but the consequent accumulation of sterling-area funds in London may, for instance, be offset against long-term debts owing by the countries concerned to British investors. In certain respects the Canadian dollar holds an intermediate position between the sterling-area currencies and the U.S. dollar and, under special agreements, payments in relation to Canada (and Newfoundland) are made through so-called "authorised accounts" in sterling. At the beginning of 1941 the Canadian Exchange Control was authorised to sanction payments out of Canadian and Newfoundland sterling accounts to settle commercial and financial obligations outside the sterling area (mostly by transfer to the United States). The rate of the Canadian dollar against sterling has been kept steady at Can.$ 4.43–4.47 = £1. On the New York market the exchange value of the free Canadian dollar has been subject to fluctuation: the lowest rate touched was 78 U.S. cents = Can.$ 1. Since the free sterling quotation recovered to the control rate, the rate has been steadier at about 85 U.S. cents for free Canadian dollars as compared with a fixed official rate of 90.9 U.S. cents.

In March 1941 the rate at which South African trade and other bills are bought by British banks was increased by 4s. 6d. to £101 8s. 0d. in order to compensate for the greater delay in transmission by post. In January 1941 the Belgian Congo and in March 1941 the so-called Free French territories in Equatorial Africa, French Oceania and French establishments in India were virtually brought within the sterling area. The rate of exchange of the pound, on the one hand, and of the Belgian and French colonial francs, on the other, has been fixed at Belgian and French colonial francs 176.625 = £1. In the last week of May 1940 the guilder of the Dutch East Indies was pegged to sterling at the rate of Fl. 7.58–7.62 = £1, and this rate has been maintained ever since. The Dutch East Indies are not, however, included in the sterling area, within the meaning of that term under the British exchange regulations (in that way differing from the French and Belgian colonies referred to above, which are technically within the sterling area). From the beginning of September 1940 the guilder of the Dutch West Indies was also linked to sterling at the rate of Fl. 7.58–7.62 = £1. Fixed rates are also quoted for the guilders of the Dutch East and West Indies to the U.S. dollar at a middle rate of Fl. 1.885 = \$1, which corresponds to a sterling rate of Fl. 7.60 on the basis of a dollar-sterling conversion rate of \$4.03.

In relation to countries outside the sterling area the British Exchange Control operates by means of a number of bilateral clearings or payments agreements, which provide for the canalisation of commercial and financial payments between the United Kingdom and the country in question through sterling accounts maintained with London banks and duly notified to the Bank of England. Usually these are known as "special accounts" but in the case of the United States and Switzerland they are called "registered accounts". With Japan no payments or clearing agreement has been concluded and in this case purchases are still made in the free market, but Japanese trade with sterling countries has dwindled, so that the resultant exchange position is not of great consequence at present. More important is the position in the Chinese market, both from a trade point of view and on account of the British participation in the Chinese Stabilisation Fund. Surplus sterling funds in the Far East have led to a discount of about 10 per cent. in the sterling rate on the Shanghai market in terms of the official U.S. dollar rate.

Of particular importance are the relations between the pound sterling and the dollar. The agreement with the United States is essentially the outcome of a private arrangement with American banks concluded with the active approval of the United States Treasury and of the Federal Reserve authorities. The agreement involves the blocking of American investments in the United Kingdom, the severe limitation of the use to which American sterling balances can be put and the gradual extinction of the "free market" for sterling in New York. Free sterling still in American hands may be used for three main purposes since the arrangement came into force: for payments in the sterling area other than for exports, for settling any sterling debt in any part of the world provided that it was outstanding before 18th July 1940, and for transfer to residents in any country with which the

Sterling-dollar Rate in London and New York.

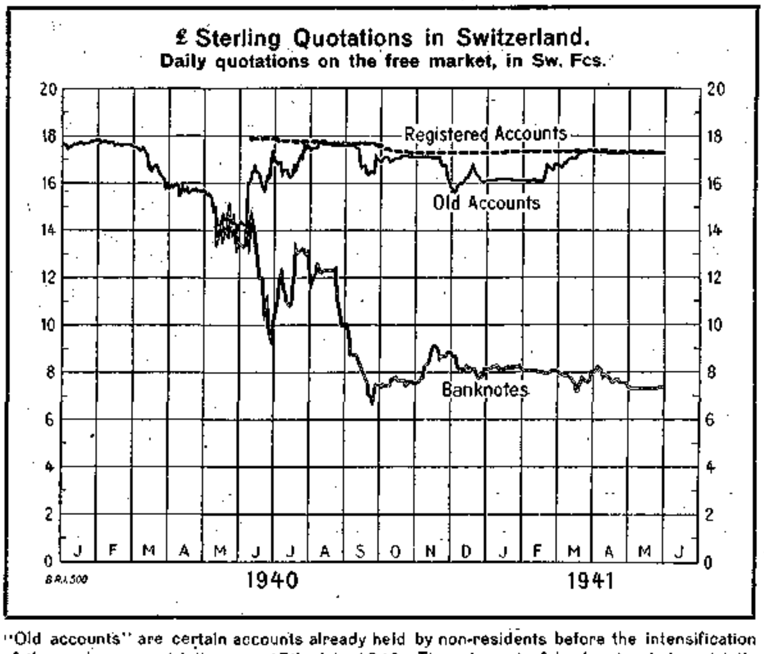


British Government has no special arrangement precluding the receipt of free sterling. Upon this arrangement the free sterling rate in New York, which had fallen to a low of $3.10 in May 1940, rapidly recovered. "Bears", who had sold sterling at a rate as low as $3, were suddenly caught and had to cover their commitments in pounds at a much higher rate.

It was reported from New York in March 1941 that the extreme narrowness of fluctuations in free sterling may be taken as an indication of the firm control which the London authorities have acquired over the whole sterling area.

Under the bilateral agreements which have been concluded such sterling balances as accumulate can as a rule be used only for payments between the particular country which holds the balances in question and the sterling area. It is true that sterling balances on registered accounts for the United States and Switzerland can always be turned into dollars and Swiss francs at the official selling rates, and the British authorities are always ready to buy dollars and Swiss francs against sterling at the official buying rates. Under other agreements the possibilities of conversion are more restricted, but, in order to prevent an undue accumulation of funds, measures are from time to time agreed upon, as, for instance, repurchases of securities in London. The agreement with Sweden, moreover, enables that country to utilise the sterling in the special accounts for payment of purchases outside the sterling area, as, e. g., in Brazil. This is, however, an exception: as a rule special authorisations are necessary for the utilisation of balances otherwise than in bilateral relations. Moreover, attempts are made to direct British exports to countries, e. g. in South America, which have accumulated sterling in their special accounts, and so to adjust the volume of trade with the various countries to the state of their clearing accounts.

On 21st August 1940 the import of Bank of England notes into the United Kingdom was prohibited except for the right granted to persons entering the country to bring with them £10 in bank-notes. At the end of January 1941 this right was restricted to bona-fide travellers and thus withdrawn from seamen and others,



£ Sterling Quotations in Switzerland.
Daily quotations on the free market, in Sw. Fcs.

"Old accounts" are certain accounts already held by non-residents before the intensification of the exchange restrictions on 17th July 1940. The reimport of bank-notes being strictly limited, the market is very narrow and the rate is given only by way of indication.

who in the course of their normal occupation make frequent journeys between the United Kingdom and neutral ports.

In the United States the gold value of the dollar has remained unchanged, the buying price of the Treasury being $35 per fine ounce less ¼ per cent. (i. e. $34.9125) and the selling price $35 plus ¼ per cent. (i. e. $35.0875). The Exchange Stabilization Fund, which was established in 1934 out of the profits on the devaluation of the dollar, amounted originally to $2,000 million, of which $1,800 million have been maintained in gold and $200 million as an active balance with the Federal Reserve Banks. By 30th June 1940 the Fund had been increased by $44 million, representing net earnings since its formation. Before the war the Fund was used primarily to exert a stabilising influence on exchange rates by intervention in the market in relation to British, French, Dutch, Belgian and Swiss currencies. This part of its activity was brought to a virtual standstill when the war began. On 30th November 1940 it was announced that, in addition to a credit of $50 million granted to China by the Export-Import Bank to assist her in her financial problems, the Treasury would make available another $50 million from the Stabilization Fund for the purpose of monetary protection and management between the American and Chinese currencies. In December 1940 it was further announced that $50 million of the Stabilization Fund would be set aside to promote stability between the dollar and the Argentine peso (in addition to a similar amount lent for other purposes by the Export-Import Bank). Stating that the new transactions represented to a certain extent a departure from the original purpose of the Stabilization Fund, the Secretary to the Treasury added that it was an Administration policy to help a friendly nation to stabilise its currency in relation to the dollar and, by thus providing dollar exchange, to help American business men in their sales.

Under the regulations issued in the United States relating to transactions in foreign exchange, transfers of credit and the export of coins and currency, as amended by an executive order of 10th April 1940, the gold and dollar resources of the following countries have been made subject to licence in the United States and are thus available for payments only with the consent of the Treasury (position at the end of April 1941): Denmark, Norway, Holland, Belgium, Luxemburg, France, Estonia, Latvia, Lithuania, Roumania, Bulgaria, Hungary, Yugoslavia, Greece.

The currency position of Latin American countries has been greatly affected by the extension of hostilities in Europe, since, apart from trade with the United Kingdom, only a few shipments could be made to Spain and Portugal. The normal triangular structure of the Latin American balance of payments, whereby excess payments to the United States were covered by excess income from Europe, has been deranged. The disturbing forces are threefold: accumulation of unsaleable foodstuffs and raw materials; resort by the United Kingdom to payment and clearing arrangements which prevent the use of sterling proceeds of trade to meet obligations outside the sterling area; and the substitution of American imports for European goods previously imported. There are, however, some counterbalancing factors: the increased demand by the United States for "strategic", "critical" and other materials of Latin American origin; credits granted by the U. S. Export-Import Bank and Stabilization Fund, through which about $250 million have been made available to Latin America; foreign investments in Latin American countries, and for some of these countries an important inflow of refugee funds, amounting to at least $60 million for the Argentine and Brazil (together) and at least $20 million for Mexico. As a result of these various movements the Argentine, Brazil and Mexico, as well as some of the other countries, have even been able to strengthen their monetary reserves, while others have been subject to great strain. In Ecuador, Paraguay and Venezuela new exchange restrictions were imposed during 1940; in Venezuela, Peru and Bolivia the currencies depreciated on balance in terms of the U.S. dollar; but by the end of the year the exchange position was as a rule well in hand.

For the Argentine three official exchange rates have been maintained: an official buying rate of Pesos 3.36 for the U.S. dollar and two official selling rates of Pesos 3.73 and 4.23 for goods considered essential, divided into two categories. Exchange for most other products is sold by auction, under regulations issued in February 1941, importers submitting bids to the central bank and the exchange going to the highest bidder, the rate varying therefore with each transaction. It was stated that this plan would permit the elimination of all exchange quotas applying to specific commodities other than those provided for in trade conventions with foreign countries. In April 1940 it had been decided to base the free market quotation of sterling on the fixed relationship of $4.02 = £1. At the end of 1940 a triangular payments agreement was concluded between Paraguay, the United Kingdom and the Argentine by which it was made possible for Paraguay to obtain Argentine pesos (virtually the only currency used in the country for international transactions) in return for sterling balances. In February 1941 a more drastic form of exchange control was introduced to counteract the results of adverse trade developments and exchange speculation.

Official and market rates quoted for the U.S. dollar in Brazil have remained stable since the spring of 1939 despite the disappearance of important markets for coffee on the continent of Europe. An agreement between coffee-producing Latin American countries and the United States (see page 61), credits from the Export-Import Bank partly for industrial investments, and an inflow of refugee funds estimated to have reached an amount of at least $25 million, have helped to sustain the exchange position. In July 1940 an agreement was concluded with regard to the transfer of dividends, under which $13.9 million and £1.6 million will be transferred within four years. In the middle of May 1940 the Bank of Brazil blocked the deposits of all European countries, with the exception of Great Britain, France and Portugal, but on the 30th of the same month the Bank of Brazil instructed the banks to free deposits and to resume exchange operations with nationals of European countries, exclusive of Norway, Denmark, Holland, Belgium, Poland, Czecho-Slovakia and Luxemburg.

In Chile, Colombia and Uruguay official dollar quotations remained unchanged all through 1940. From time to time difficulties in providing foreign exchange were experienced; exchange controls were reinforced, especially in Colombia, but further depreciations of the currencies were avoided. In November an Anglo-Chilean payments agreement was concluded covering all commercial and financial settlements between Chile and the sterling area. Sterling rates are to be determined through the cross quotation of the London gold price and the dollar rate in Chile. In Bolivia, after a decline in the exchange value in the spring of 1940, the currency was attached to the dollar at a rate of Bs.40 = \$1 for necessary imports, and for other imports at a compensation rate of Bs. 55. In Peru, also, after a weakness of the exchange in the spring, the dollar has been maintained since May 1940 at a rate of Sols 6.50 = \$1. Peru has no exchange restrictions but has strengthened her trade position by imposing duties on luxuries and some other commodities. In Venezuela, where the currency had been held at very nearly its 1929 gold value up to the end of 1939, a 20 per cent. depreciation occurred in the latter half of 1940; the free exchange market was abolished and a strict control imposed on imports and foreign exchanges. A credit was obtained from the National City Bank of New York, whereupon the exchange quotas allowed for imports were increased by about 50 per cent. After a sudden weakness of the exchange position in Ecuador exchange control was re-established in June 1940 and control over imports in October; by the end of the year the decline had been recovered and in December the dollar rate was fixed at Sucres 14.8 for purchases and Sucres 15 for sales.

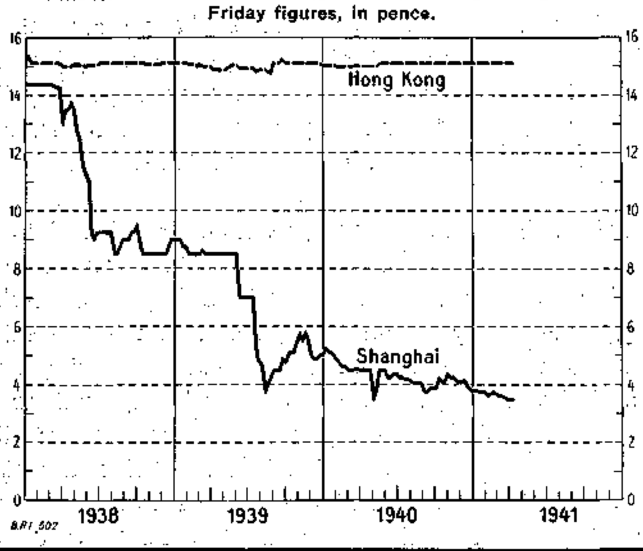
The Mexican peso, after a pronounced weakness in the first half of 1940, became strong in the autumn when, as a result of fears that the United States would participate in the war, dollars were sold on the free market, the Bank of Mexico buying these dollars at a rate of Pesos 4.85 = \$1. The heavy influx of capital has strengthened the reserves of the Bank of Mexico and enabled the country to abstain from the imposition of exchange control. In Cuba the peso was selling at a discount of about 9 per cent. against the dollar at the beginning of 1941, i. e. much the same rate as a year earlier. No exchange restrictions are in force and the same applies to the Dominican Republic, El Salvador, Guatemala, Haiti and Panama.

Far Eastern Currencies. The Japanese yen has continued to be pegged to the U.S. dollar at a rate of Yen 100 = \$23.44. This was the rate adopted in October 1939 after the yen had abandoned its link with sterling in the previous month and depreciated by 14 per cent., i. e. to the same extent as the official sterling rate. No payments or clearing agreement having been concluded between Japan and the United Kingdom, the market quotations for sterling against the yen have fluctuated in sympathy with the free sterling rate in New York, attaining to an average of 1s. 5d. in May 1940 and returning to 1s. 2d. in the following August, since when the sterling rate has remained unchanged. In addition to the circulation of the Bank of Japan, yen notes are issued by the Bank of Chosen and the Bank of Taiwan. The

Manchukuo yuan (the currency issued by the Central Bank of Manchou) was pegged to the yen at a rate of Yuan 1 = Yen 1 on 4th November 1935 when Manchukuo ceased to adhere to the silver standard (cutting loose from the rise in the price of silver under the influence of purchases by the U.S. Treasury). All transfers of funds between Manchukuo and Japan in excess of Yen 3,000 require exchange permits and are made through the Central Bank of Manchou at the par rate of exchange. It was decided in February 1940 that all foreign exchange acquired by Manchukuo should be delivered to Japan and that in return Japan should furnish Manchukuo with the foreign currencies required to purchase materials necessary for her industrial and agricultural development. This indirect method of financing is, for the time being, applied to all the foreign commerce of Manchukuo, with the exception of trade with Germany and Roumania — two countries with which special clearing and barter agreements have been concluded.

The currency of the National (Chiang Kai-Chek) Government of China, established in Chungking since 1938, is the Chungking yuan, also known as the Chinese (standard) dollar or the Chinese yuan or the Shanghai dollar, but popularly called the "fapi". It was introduced at the end of 1935 when China gave up the silver standard and made arrangements for supporting her currency by being ready to buy Chinese dollars for sterling at about 1s. 2½d. The right of note issue belongs to four leading Chinese banks: the Central Bank of China, the Bank of Communications, the Bank of China and the Farmers' Bank of China. After hostilities had broken out with Japan in July 1937 the Chinese dollar depreciated sharply and from August 1938 to May 1939 it was quoted around 8½d. In the summer of 1939 a new depreciation set in, reaching its lowest point in August with a rate of 3½d., from which the currency only temporarily recovered. By another depreciation in the first half of 1940 it fell to about 3⅛ d. and has recently fluctuated around 3½ d., which is approximately equivalent to a rate of Yuan 1=5½ U.S. cents.

Sterling quotations of Shanghai and Hong Kong dollars.
Friday figures, in pence.



The Hong Kong dollar has continued to be pegged in relation to sterling.

Towards the end of 1940 the exchange position of the Chungking yuan (as the currency of the Chungking Government may perhaps best be called to avoid confusion) was strengthened by credits granted by the British and United States Governments.

Thus the British arranged for a loan of £10 million of which one half was for purchases of war materials and the other half for exchange support (the new £5 million credit being additional to the £5 million guarantee given by the British Government in 1939); the American loan was to the amount of $100 million ($50 million from the Export-Import Bank and $50 million from the Stabilization Fund for exchange support). Exchange agreements were signed on 25th April 1941 between China, on the one hand, and the United States and the United Kingdom, on the other. The agreements provide for the establishment by China of a Stabilisation Fund, which will be managed by a Stabilisation Board to be set up by the Chinese Government. The Board will consist of five members, comprising three Chinese nationals, an American appointed by China upon the recommendation of the Secretary of the U.S. Treasury, and a British national appointed upon the recommendation of the British Treasury.

Between the Japanese yen, on the one hand, and the Chungking yuan, on the other, a kind of monetary warfare has arisen. No fewer than four new banks of issue have been established with the aid of Japan since 1937, namely: (i) the Central Bank of Inner Mongolia, established at Changchiakou (Kalgan) in 1937; (ii) the North China Federal Reserve Bank, established at Peiping in 1938; (iii) the Hua-Hsing Commercial Bank, established at Shanghai in 1939; and (iv) the Central Reserve Bank, established at Nanking in 1940.

The Central Bank of Inner Mongolia was established in 1937 by the three autonomous governments of Inner Mongolia, which each subscribed Yuan 4 million to its capital (one-quarter being paid up). The currency issued is known as the Mengku yuan; it is theoretically linked, at par, to the Manchukuo yuan but in practice follows the rate of the Chungking yuan. Other foreign currencies than the yen and its satellites are acquired when necessary through the Chungking yuan in the Tientsin market. In general the capital needed in Inner Mongolia has for a long time been obtained from the Tientsin-Peiping area and the financing of the country's foreign trade has mainly been in the hands of foreign banks in that area. One of the reasons for the introduction of exchange restrictions and control of foreign trade in the summer of 1940 was the desire to make Inner Mongolia more independent of foreign financial influences.

The North China Federal Reserve Bank was established in March 1938 as a bank of issue for the three provinces Shantung, Shansi and Hopei. At that time these provinces were governed by the so-called "Provisional Government", but from the autumn of 1940 (when the National Government of Wang Ching-Wei was established in Nanking) they came under the control of the "Political Committee of North China". The Bank has a capital of Yuan 50 million, of which Yuan 25 million has been paid up, one half by the government and the other half by eight Chinese banks. The amount subscribed by the government was advanced by the Yokohama Specie Bank, the Bank of Chosen and the Industrial Bank of Japan. In order to maintain the exchange value of the yuan of North China (usually called the Tientsin yuan) an Exchange Equalisation Fund was established and provided with a credit of Yen 100 million from a syndicate of fourteen Japanese banks. The Tientsin yuan is theoretically linked to the Japanese yen, but in practice its exchange value has been affected by the movements of the Chungking yuan. In the spring of 1940 it was even more depreciated than the latter, but a recovery set in, so that on 5th June Tientsin Yuan 90 were equal to Chungking Yuan 100. This improvement is reported to have been partly due to the prohibition to import goods without utilising exchange notes (a measure by which the activity of European banks in financing foreign trade with the aid of the Chungking yuan has been largely arrested) and partly to the agreement concluded with the administrative authority of the International Concessions in Tientsin as to the disposal of Yuan 52,993,000 in silver. The improvement has continued: on 6th February 1941 Tientsin Yuan 78.25 were equal to Chungking Yuan 100 on the Shanghai exchange market. The Tientsin yuan is the only currency accepted for customs payments in the three Northern Provinces.

The Hua-Hsing Commercial Bank in Shanghai was established in May 1939, by the predecessor of the Wang Ching-Wei Government in Nanking, with a capital of Yuan 50 million — one half subscribed by the government and the other half by six Japanese banks. The original intention was to create a bank of issue which would eventually develop into a central bank for the whole of China. The Hua-Hsing yuan was at first aligned at par with the Chungking yuan but, when the latter depreciated in the summer of 1939, it was stabilised at a rate of Hua-Hsing Yuan 1 = 6d. It thus appreciated in terms of the Chungking yuan, and on 6th February 1941 it was quoted at a rate of Hua-Hsing Yuan 1 = Chungking Yuan 1.79. The Hua-Hsing yuan was, however, of little use in export trade. Its total circulation is reported to have been only about Yuan 6 million, compared with a total note circulation of Yuan 600 million in the Shanghai area. When the new central bank was opened in Nanking at the beginning of 1941, the Hua-Hsing Commercial Bank was deprived of its note issue privilege and is to operate in future exclusively as a commercial bank.

The Central Reserve Bank in Nanking was constituted by the National (Wang Ching-Wei) Government after its formation in 1940, the bank opening on 6th January 1941. Its capital of Yuan 100 million has been subscribed entirely by the government, and the Minister of Finance is the Governor of the bank.

The currency unit in which the new bank issues its notes is called the Nanking Central Reserve Bank yuan, which has been given the same value as the Chungking yuan. It was announced on the date of the opening of the new bank that the head office had issued Yuan 7 million in exchange for "fapi", i. e. the currency of the Chungking Government, which the Nanking Government opposes. In the beginning the new bank was prepared to exchange the "fapi" notes of the Chungking Government, unconditionally and without discrimination, against its own; but as a first exception the notes of the Farmers' Bank were excluded. Then on 8th February 1941 the following modifications were made: all notes issued before 1939 by the Central Bank of China, the Bank of China and the Bank of Communications were to be convertible into Nanking Central Reserve Bank notes, except the denominations of Yuan 50 and Yuan 100 and except subsidiary notes other than those of Yuan 1. By these provisions all recent notes expressed in Chungking yuan are excluded from conversion. Both currencies are to be acceptable at par for payment of customs duties in Shanghai, where customs collections have recently run between Yuan 20 and 40 million per month.

In the first months of 1941 the Chungking yuan seems to have maintained its exchange position relatively well almost without official support. The trade balance of the Shanghai area seems to have somewhat improved; general world developments (increased foreign demand for Chinese products and rising prices abroad) are probably favourable to China; and the credits granted by the British and United States Governments are also conducive to improved sentiment. The decisive factor in the long run will no doubt be the degree in which the Chungking Government is able to avoid inflationary financing. The note circulation of the four Chinese banks which have the right to issue the Chungking yuan is officially reported to have risen from 2,627 million at the end of June 1939 to 3,962 million at the end of June 1940. The following table, obtained from the Bank of Japan, shows the amounts placed in circulation by banks of issue supported by Japan, at the end of 1939 and 1940.

Circulation of Banks of Issue supported by Japan.

End-of-year figures in millions of yen	1939	1940
Bank of Japan	3,679	4,777
Bank of Chosen	443	580
Bank of Taiwan Ltd	171	199
Central Bank of Manchou	623	947
Bank of Mengchiang	60	93
Federal Reserve Bank of China	458	715

The Central Reserve Bank of China in Nanking opened for business on 6th January 1941 and the actual note circulation was Yuan 33 million at the end of April 1941.

The table does not include the Yuan 6 million issued by the Hua-Hsing Commercial Bank or the military scrip outstanding. It has been calculated, on the basis of information received from authoritative sources, that the military scrip in circulation at the end of 1940 amounted to Yen 120 million in Central China and Yen 50 million in South China. In February 1941 the military scrip was quoted in Shanghai at a rate of Chungking Yuan 1.76 and notes of the Bank of Japan (which may not be repatriated into Japan) at Chungking Yuan 1.60, compared with a cross rate of Chungking Yuan 4.40 = Yen 1 on the basis of the pegged dollar value of the yen. Commodity prices have risen all over the Far East since 1936: in Japan by fully 60 per cent., in Manchukuo by about 130 per cent., in Tientsin by about 400 per cent. and in Shanghai by perhaps 500 per cent. There is a certain tendency for the various currencies to approximate to their purchasing power parities. The Shanghai exchange market remains free from official restrictions, the currencies finding their level with such support as the monetary authorities may see fit to apply from time to time. The anomaly of the currency situation in the Far East is perhaps best illustrated by the fact that in so far as the Chungking Government lends support to the exchange value of its currency it does so in the Shanghai market, which is under Japanese control and may be used by the Japanese for the acquisition of foreign exchange. The question has arisen whether or not the Chungking Government could and should limit its support to areas effectively under its control or whether it should continue to sustain confidence in its currency by support on the Shanghai market also. At the time of writing it is not known whether the new Stabilisation Board, set up by the Chungking Government in connection with the credits granted by the British and United States Governments, has as yet come to a decision on this point.

On the Shanghai exchange market foreign currencies may be bought without any questions being asked as to the purpose of the transaction, whether it is for commercial or financial settlements or to effect a flight of capital. The same freedom from restrictions appertains to the U.S. dollar, the Mexican peso and certain other Latin American currencies. In Europe free exchange markets are found in Portugal and Switzerland, but in both these countries the central banks have come to informal arrangements with the private banks to prevent, in particular, a flight of capital. Systems of exchange control and the application of fixed rates in clearing and payments agreements more and more exclude arbitrage operations and quotations of forward rates. The foreign exchange markets no longer provide sensitive indexes of variations in economic tendencies and in capital movements, as was the case in the past. Under the strain of the present war emergency, however, important changes occur in the cost and price structure, in the volume of money and the foreign trade position of almost every country; and it is inevitable that, beneath the apparent stability, seeds of maladjustment are sown which sooner or later will affect the relationship between the different currencies. For the moment it is certainly not easy to determine what should be regarded as true equilibrium rates. When trade is virtually cut off between countries (as, for instance, between most European countries and the United States) the relative levels of costs and prices are not of any *immediate* importance. Even when commercial relations are maintained widely divergent tendencies often occur in the prices of imported and exported goods unequally affected by high transportation costs and a number of other factors; these divergences may have an important though perhaps only transitory influence on the terms of trade. Many of the exceptional factors which at present affect the balances of payments will no doubt disappear when foreign trade resumes its peaceful course. Apart from structural changes, about which it is difficult to generalise, it will probably be found that such cost elements as wages and salaries, because of their resistance to a downward adjustment, will have a decisive effect on the future intrinsic value of the various currencies.

2. FOREIGN TRADE.

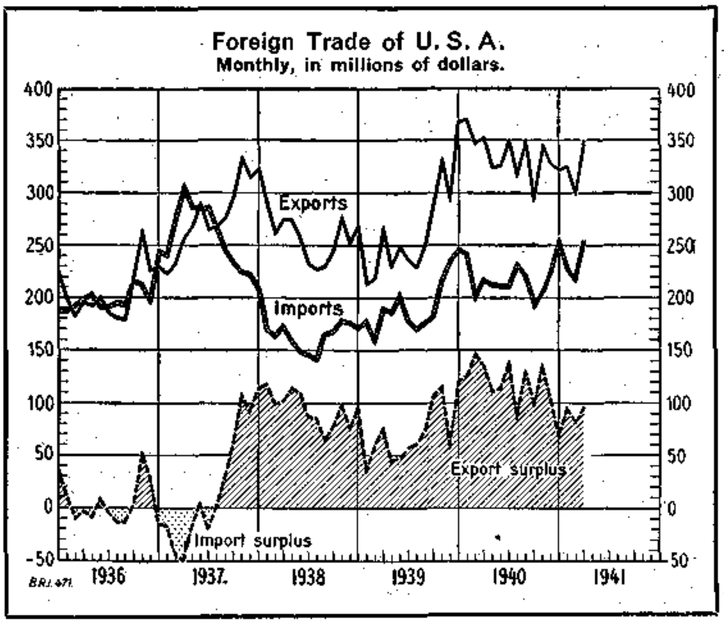
Since in modern warfare measures of blockade and counter-blockade (large-scale applications of the ancient methods of siege) are designed to interrupt the foreign trade of the opponents, it is natural to find the publication of commercial statistics reduced to a minimum. For some countries, e.g. Belgium, France, Germany, Japan and Norway, the regular publication of all foreign trade returns has been discontinued, although from time to time some general indications of the main tendencies may be given. For other countries, e. g., the United Kingdom, Switzerland and Sweden, the analysis of the geographical distribution of trade has been suppressed and the returns have been "simplified" in other ways also. It is no longer possible to calculate the total value or volume of the world's foreign trade and it is sometimes uncertain to what extent trade in war implements is included in the various returns. Finally, it seems to be a general feature that prices of goods which are imported and exported have been subject to greater price changes than domestic products; for this reason great caution must be exercised when figures for 1940 are compared with those for previous years.

Among the great powers only the United States continues the publication of its trade returns on a normal basis and a review of world trade may therefore usefully begin with an indication of the tendencies revealed by these statistics. The following figures show the total value of the foreign trade of the United States in recent years.

United States Foreign Trade 1937–1940.

$ millions	Exports	Imports	Balance
1937	3,349	3,084	+ 265
1938	3,094	1,960	+ 1,134
1939	3,177	2,318	+ 859
1940	4,021	2,625	+ 1,396

In the trade depression of 1938 imports fell heavily, but exports kept up well, with the result that an export surplus arose exceeding $1 milliard — the highest since 1921 with the single exception of the year 1928. Foreign demand for U. S. goods subsided somewhat in the early months of 1939 when exports were substantially lower than in the preceding year. Beginning with the month of June the country's exports began to show an upward trend, which became more pronounced after the outbreak of war in September 1939 and the removal on 4th November 1939 of the prohibitions in the Neutrality Act (of 1937) against selling arms, ammunition and instruments of war to belligerent countries. Notwithstanding the disappearance of important markets on the Continent of Europe,



U. S. exports in 1940 were larger in both value and volume than in any year since 1929. Not even the extension of warfare in the spring of 1940 caused any appreciable decline in the export figures: total exports in the second half of the year were only 5 per cent. below those of the first six months. As the following table shows, increased exports to the British Empire and (in absolute figures) to Latin America have compensated for the decline in the shipments to Continental Europe, U. S. exports to Europe as a whole remaining nearly the same, at about 40 per cent. of the total exports.

United States Exports to Different Areas in 1939 and 1940.

Period	Exports to							Total Exports
	British Empire			Con-tinental Europe	Latin America	Japan	all other areas	
	United Kingdom	Canada	Total*					
	in millions of dollars							
1939								
First half	230	202	565	336	249	111	155	1,416
Second half	276	287	714	437	320	121	169	1,761
1940								
First half	359	317	845	541	378	107	194	2,065
Second half	651	398	1,248	84	348	120	157	1,957
	in percentages of total							
1939								
First half	16	14	40	24	18	8	11	100
Second half	16	16	41	25	18	7	10	100
1940								
First half	17	15	41	26	18	5	9	100
Second half	33	20	64	4	18	6	8	100

* Including other Empire countries.

In the first half of 1940 increased exports to France, the Scandinavian countries, Holland, Belgium and Switzerland were sufficient to maintain the share of Continental Europe at the usual proportion of about a quarter of total U.S. exports, but in the second half of the year the share of Continental Europe fell to only 4 per cent., accounted for mainly by trade via Lisbon. The share of the United Kingdom has doubled from 16 to 33 per cent., and in the second half of 1940 nearly two-thirds of U. S. exports went to the British Empire. The pre-war share of 18 per cent. taken by Latin America remained unchanged although export values increased by 27 per cent. from 1939 to 1940. The export trade to Japan and "all other areas" lost in relative importance, but absolute figures were maintained.

Considerable changes have occurred not only in the destination but also in the character of U. S. exports since the war began, expansion being concentrated largely on materials essential for the conduct of war.

While exports of war materials increased, those of agricultural products slumped. Normally the United Kingdom constitutes the major single market

U. S. exports of manufactures and other products in 1939 and 1940.

Period	Manufactures		Agricultural		Other crude materials	Total
	Six essential war materials (1)	Other manufactures	Raw Cotton (2)	Other agricultural products		
	in percentages of total					
1939 First half . . .	21	54	5	14	6	100
Second half. .	24	47	10	12	7	100
1940 First half . . .	33	44	9	9	5	100
Second half. .	43	43	2	7	5	100

(1) Includes heavy iron and steel, non-ferrous metals, metal-working machinery, aircraft, firearms and chemical products.
(2) The unusually large shipments of cotton in the second half of 1939 and the first half of 1940 were due more to the replenishment of low stocks abroad and the assistance rendered by the export subsidy on cotton than to the direct repercussions of war.

for agricultural exports from the United States, while the Continent of Europe is of only slightly less importance. With the extension of the war in 1940 sales to Continental Europe have almost ceased and even sales to the United Kingdom have been curtailed. In the second half of 1940 agricultural exports from the United States amounted to only $166 million, the lowest figure since 1869. These developments are in striking contrast to the increased European demand for U. S. foodstuffs which arose in 1915. With reference to earlier periods it is of interest to note the connection between the persistent decline in agricultural exports from the United States since the beginning of the present century and the declining importance of Europe as a whole in the foreign trade of the United States.

U. S. Agricultural Exports as Percentage of Total Exports.

Period	Percentage
1900	60
1911–15	50
1929	33
1939	21

Percentage of U.S.Trade with Europe*.

Percentages of total exports or imports	Exports to Europe	Imports from Europe
1900	75	52
1910–14	60	50
1929	45	30
1939	41	27

* Including the British Isles.

These changes are the accentuation of a long-term trend reflecting the growing relative importance of countries outside Europe and the increase of agricultural production outside the United States.

General imports into the United States advanced 13 per cent. from 1939 to 1940, but the total was still considerably below the comparatively large imports in 1937 when purchases abroad were stimulated by high industrial activity and short crops in the United States. The increased imports during 1940 reflected mainly the rise in industrial production, but they were also due to an accumulation of defence materials by the government and efforts of American industrialists to build up inventories of foreign materials.

United States Imports according to Economic Classes in 1939 and 1940.

Period	Principal strategic materials [1]	Other crude materials and manufactures	Foodstuffs	Finished manufactures	Total [2]
	in millions of dollars				
1939 First half	172	456	291	154	1,072
Second half	250	498	313	143	1,204
1940 First half	276	542	301	124	1,243
Second half	379	542	261	115	1,297
	in percentages of total				
1939 First half	16	43	27	14	100
Second half	21	41	26	12	100
1940 First half	22	44	24	10	100
Second half	29	42	20	9	100

(1) Crude rubber, raw silk, tin, nickel, antimony and ferro-alloying ores and metals.
(2) Imports for consumption only.

The increase in imports is almost wholly accounted for by the larger purchases from abroad of six principal strategic materials, which in the second half of 1940 represented 29 per cent. of total imports compared with 16 per cent. prior to the outbreak of the war. Imports of finished manufactures have abruptly fallen to less than 10 per cent. of the total as a consequence of the decline in trade with Continental Europe since the middle of 1940. In the latter half of 1940 the United States received only 11 per cent. of its total imports from the whole of Europe (including the United Kingdom) compared with about 50 per cent. in the period 1900–14 and about 30 per cent. in the years 1929–38.

United States Imports, showing Shares of Different Areas in 1939 and 1940.

Period	British Empire			Continental Europe	Latin America	Japan	All other areas	Total
	United Kingdom	Canada	Total *					
	in millions of dollars							
1939								
First half	73	149	379	237	253	61	164	1,094
Second half	77	191	450	226	265	100	183	1,224
1940								
First half	78	184	523	164	323	67	217	1,294
Second half	77	239	608	64	297	92	270	1,331
	in percentages of total							
1939								
First half	7	14	35	22	23	6	15	100
Second half	6	16	37	19	22	8	15	100
1940								
First half	6	14	40	13	25	5	17	100
Second half	6	18	46	5	22	7	20	100

* Including other Empire countries.

There is a marked increase in the import of commodities furnished by the British Empire: newsprint and nickel from Canada, rubber and tin from British Malaya, wool from Australia and jute burlap from British India. If, in addition to the merchandise trade, account were taken of the gold shipments from South Africa and other gold-producing British areas, the share of the British Empire in American imports would be well above the 46 per cent. to which it had risen in the second half of 1940. The value of imports from Latin America still represents the same proportion of the total, but quantities have risen, the blockade having caused a piling-up of surplus stocks, with a consequent decline in prices of coffee, sugar and several other foodstuffs dependent on European markets. Imports from Japan show only a slight decline, but imports from "all other areas" are rising, including tungsten, raw silk and tin from China, rubber and tin from the Dutch Indies, and ferro-alloying ores, tin and cobalt from the Belgian Congo.

The export surplus in 1940 amounted to nearly $1,400 million, distributed as is shown in the following table.

U.S. Trade Balance with Different Areas in 1940.

In millions of dollars	Exports	Imports	Balance
British Empire			
United Kingdom	1,010	155	+ 855
Canada	715	424	+ 291
Other Empire countries .	368	551	— 183
Total British Empire	2,093	1,130	+ 963
Continental Europe . .	624	227	+ 397
Latin America	727	620	+ 107
Japan	227	158	+ 69
Other areas	351	490	— 139
Grand total . . .	4,022	2,625	+1,396

In relation to the British Empire the export surplus was largely met by shipments of newly produced gold, which in 1940 amounted to about $850 million. The United Kingdom has, however, paid for deliveries in advance and also provided funds for investment in American armament industries, and has therefore drawn on its gold and dollar resources in the United States in a larger measure than was needed to pay for current shipments of goods.

Those countries in Continental Europe (France, Holland, Belgium, Switzerland, Sweden, etc.) which in the first four months of 1940 imported from the United States up to the limit of available transport facilities, paid for their excess imports by drawing on their gold and dollar holdings in New York. Latin America has no longer been able to use proceeds of exports to Europe for payments in the United States but has been assisted by credits from the Export-Import Bank and the Exchange Stabilization Fund, which by the end of 1940 amounted to over a quarter of a milliard dollars. Japan has had to rely on gold exports to procure the resources needed to meet payments for large purchases in the United States. "All other areas", including in particular the Dutch East Indies, have sold more than they have bought on the American market and have thus experienced no difficulty in procuring the necessary dollars.

The extent to which American exports have become concentrated on the British Empire is shown by the fact that in the latter half of 1940 the United States had a passive balance with other countries than the British Empire.

U. S. Trade with the British Empire and all other countries in the second half of 1940.

In millions of dollars	British Empire	All others	Total
Exports to	1,248	709	1,957
Imports from	608	723	1,331
Balances	+ 640	— 14	+ 626

Normally, the United States furnishes by far the largest part of Canada's imports, while the British Empire — in particular the United Kingdom — takes the largest part of Canadian exports. Since the war began this tendency has been even more pronounced. As the following table shows, the export surplus to the United Kingdom and the import surplus from the United States have both risen.

Foreign Trade of Canada 1938-40.

In millions of Canadian dollars	1938	1939	1940
Exports			
Merchandise	836	897	1,186
Non-monetary gold (net)	161	184	203
Total exports	996	1,081	1,389
Total imports	677	751	1,082
Balance	+ 319	+ 330	+ 307
Trade with United Kingdom			
Exports* to	334	331	533
Imports from	119	114	161
Balance	+ 215	+ 217	+ 372
Trade with United States (merchandise)			
Exports* to	261	336	417
Imports from	425	497	744
Balance	— 164	— 161	— 327

* Export of Canadian produce excluding gold.

Canada being a gold-producing country, account must be taken of the net exports of non-monetary gold. In 1940 (contrary to the previous year) the import surplus from the United States was not covered by the net export of such gold. In order to reduce the export surplus in relation to the United

Kingdom, certain facilities (including tariff reductions) have been granted for imports of British goods to Canada; and as a result there has been an increase in the imports from the United Kingdom compared with 1939. The rise in imports from the United States is mainly due to larger purchases in the so-called "war categories": machinery and vehicles (including aircraft), metals and textiles. In order to economise the country's dollar resources, which have been strengthened by mobilisation of American securities, and also to curtail luxury spending at home, Canada, in June 1940, imposed a 10 per cent. war exchange tax on all imports from non-Empire sources and, in December, prohibited (except under licences) the import from non-sterling areas of passenger automobiles, certain articles of clothing, electrical appliances and several other items. At the same time heavy excise duties were established to prevent the expansion of domestic production of articles of which the import was prohibited or restricted. There has been a certain shift in cotton imports to purchases from Brazil, but even so the import surplus in relation to the United States has continued to increase.

Foreign Trade of the United Kingdom 1939–40.

In millions of £ sterling	1939 Monthly average	1940 Monthly average
Imports		
First four months	72	105
Last eight months	75	85
Year's imports	74	92
Exports (including re-exports)		
First four months	43	46
Last eight months	39	32
Year's exports	40	37
Balance	— 33	— 55

Figures showing the direction of the foreign trade of the United Kingdom are no longer published, but changes in the volume of monthly imports and exports give an indication of the effects produced by the military events in the spring and summer of 1940, by which British trade with Continental Europe was almost wholly cut off.

Imports and exports rose steadily during the first four months of 1940 but fell abruptly from May onwards, rising again only at the end of the year. The table on the next page shows the main categories of British imports and exports.

The percentage increase is the same for imports of "articles wholly or mainly manufactured" and "raw materials and articles mainly unmanufactured". Imports of "food, drink and tobacco" have risen in value but, in view of higher transport costs and the decline in the exchange value of the pound, they must have fallen in volume. Notable reductions are found in the shipments of coal (important markets having been lost) and sales of machinery (needed for the increased armament production at home). On the other hand, there has been an increase in exports of beverages and chemicals. The figures seem to indicate that exports to those countries with which trade remains possible have gone up in comparison with previous years. In order to conserve foreign exchange, particularly dollar exchange, for the purchase

Foreign Trade of the United Kingdom (main categories).

Yearly figures — in millions of £ sterling	1939	1940	Percentage change
Imports			
Food, drink and tobacco	398	421	+ 6
Raw materials and articles mainly unmanufactured	241	336	+ 40
Articles wholly or mainly manufactured	239	336	+ 40
Animals not for food	3	2	— 24
Parcel post	4	4	— 5
Total imports	886	1,100	+ 24
Exports			
Food, drink and tobacco	36	33	— 7
Raw materials and articles mainly unmanufactured	54	36	— 33
Articles wholly or mainly manufactured	338	336	— 1
Animals not for food	1	1	+ 20
Parcel post	11	7	— 37
Exports of domestic goods	440	413	— 6
Re-exports	46	26	— 43
Total exports	485	439	— 10

of military supplies and to support various classes of producers in the Dominions and Colonies, the import controls established in the United Kingdom have endeavoured to concentrate purchases of particular commodities so far as possible within the British Empire and certain allied countries, e. g. Egypt.

The extent to which war conditions have intensified the commercial relations between the United Kingdom and the rest of the Empire may be illustrated by the trade of New Zealand: in 1940 about 87 per cent. of New Zealand's exports went to the United Kingdom, compared with 80 per cent. in 1938. With a view to conserving foreign exchange for important war purposes the Import Control Scheme, originally introduced in the autumn of 1938, was employed to reduce drastically the less essential imports, and especially imports of goods competing with local manufactures such as clothing footware and manufactured tobacco. After severe restrictions on the use of petrol, imports of motor vehicles were reduced by three-quarters and petrol imports for private and commercial consumption by about one-tenth. The surplus of exports in 1940 was £N. Z. 24.7 million, an amount twice as high as the £N. Z. 12 million normally regarded as required to meet debt charges and other invisible items abroad.

In Australia attempts to limit imports by prohibitions and licensing did not achieve any reduction in the total volume of goods purchased from abroad. During the year July 1939—June 1940 total imports rose by £A 10 million to £A 145 million, while exports of merchandise rose by £A 15 million to £A 149 million. In addition, the output of gold, all available for export, rose by £A 3 million to £A 17.6 million. The balance of merchandise trade and gold was not quite sufficient to meet the current liabilities for debt service, which are usually estimated at about £A 30 million a year.

The foreign trade of the Union of South Africa on merchandise account also expanded in 1940. Imports rose by £13 million to a total of £ 137 million, covered by exports of merchandise to the extent of £33 million and for the remainder by exports of gold. The output of gold from the mines was valued at £114 million in 1940 — an advance of £18 million compared with the previous year.

The most remarkable expansion in respect of any area within the British Empire is revealed by the trade returns of British Malaya, where during the first nine months of 1940 exports rose in value by 71 per cent., compared with the corresponding period of the previous year, and imports by 43 per cent. In value the exports of rubber increased by 90 per cent. and those of tin by 134 per cent., these products together accounting for two-thirds of the area's export trade. The main customer was the United States, as shown by the accompanying figures.

Foreign Trade of British Malaya.

In millions of Straits dollars	January – September		Percentage change
	1939	1940	
Exports to:			
United States	189	424	+ 124
United Kingdom . . .	63	127	+ 102
Japan	43	45	+ 5
France	29	43	+ 48
Canada	18	36	+ 100
All others	153	170	+ 11
	495	845	+ 71
Total imports	445	634	+ 43
Balance	+ 50	+ 211	+ 322

Other raw-material-producing areas of the world have been in a less fortunate position. Thus the character of the production and trade of the twenty Latin American republics has rendered them particularly vulnerable to the wartime interruption in trade. In 1938 nearly 30 per cent. of their aggregate exports went to Continental Europe, 17 per cent. to the United Kingdom, and 30 per cent. to the United States. Among themselves these republics provided markets for less than 10 per cent. of each other's exports. (Since they are all large-scale producers of raw materials, there is little scope for an intra-continental exchange of goods.) The remainder of their trade was scattered among a number of countries, with Japan as the most important.

The aggregate trade balance* of Latin America with Continental Europe in 1938 was as follows:

Exports: $525 million, 29 per cent. of total exports.

Imports: $517 million, 34 per cent. of total imports.

The values of imports and exports in commerce with Continental Europe were practically equal, which is not astonishing considering that with Germany

* According to Latin American trade statistics.

and some of the other countries concerned trade was carried on under clearing arrangements. From the summer of 1940 exports to and imports from Continental Europe were reduced to a slight trickle, with certain reservations for Portugal and Spain.

But also in relation to the United Kingdom certain difficulties have arisen. In 1938 Latin America sold goods to the United Kingdom to the extent of \$310 million and bought goods to the extent of about \$175 million*. The difference was, in the main, needed to meet debt service, but a part was probably available for payments in other countries. Since foreign exchange regulations have been imposed in the United Kingdom and trade agreements have been concluded with practically all Latin American countries, payments due to them are made into special accounts, which can be drawn upon only for payments for purchases within the sterling area. Consequently, such surplus balances as accumulate in London can as a rule no longer be used to meet outlay in other directions, e. g. payments for excess imports from the United States. While Latin America's trade with the United States is centred in the Caribbean and Central American areas, including Mexico, 80 per cent. of the British purchases in Latin America are taken from four nations — the Argentine, Brazil, Chile and Uruguay. Up to the middle of 1940 the United Kingdom rather increased her imports from these four countries and was able to maintain or even develop her exports, but since then imports, especially from the Argentine, have fallen.

The main compensating element in the foreign trade of the Latin American republics has been an increased exchange of goods with the United States.

United States Trade with Latin America 1938–40.

In millions of dollars	Sept. 1938 to Aug. 1939	Sept. 1939 to Aug. 1940	Percentage change
U. S. exports to Latin America . .	490	733	+ 50
U. S. imports from Latin America .	469	616	+ 31
U. S. active balance	21	117	.

The figures in this table are those of the United States and thus represent values in United States ports. If account be taken of the additional cost of ocean freights, insurance, etc. to the Latin American republics, the disparity between their imports and exports would be increased by more than \$100 million in the period September 1939 – August 1940, and their passive balance would perhaps be as high as \$250 million. This is a heavy deficit for a continent which, in addition, has to meet the service of foreign debts. Various steps have been taken to cope with the situation which has thus arisen.

In the first place most countries in South America have tightened up their systems of trade and exchange control. Ecuador and Venezuela imposed a system of permits for imports during the year, and Peru, which does not

* According to Latin American trade statistics.

apply any formal exchange control, increased duties on a range of products considered luxuries or domestically replaceable and restricted the import of certain cereals. In Central America similar measures have been less common: no fewer than six out of the ten republics of that area are able to dispense with formal exchange control, namely Mexico, Guatemala, El Salvador, Panama, Haiti and the Dominican Republic.

Efforts have further been made to dispose of surpluses of commodities, and in this connection active aid is being granted by the United States. Arrangements have been made to erect a large tin-smelting plant in the United States, to operate with Bolivian ore. An agreement regarding coffee, drafted by the Inter-American Financial and Economic Advisory Committee, was signed in November by representatives of fourteen coffee-producing countries in Latin America and by the United States. It provided for the establishment of quotas governing the exports of the fourteen countries to the United States, which is the world's largest consumer of coffee, and made an allotment for markets other than the United States as they again become available. An interesting feature of the agreement is that, besides the producing areas, the main consuming country has played a decisive rôle in the fixing of the quotas and participates in the management of the scheme, which is entrusted to the Inter-American Coffee Board in Washington. The agreement covers exports to the United States market of 15.55 million sacks of coffee (about 933,000 tons), in which Brazil's share amounts to 9.3 million sacks and that of Colombia to 3.15 million.

The diversion of United States trade to Latin America is hampered by the fact that about 40 per cent. of total Latin American exports are competitive with those of the United States and therefore cannot be readily absorbed by the market in that country. It was estimated in 1940 that theoretically the United States could increase imports from Latin America as a whole by over $300 million if it relied entirely on western hemisphere sources for its casings, hides, skins, wool, cashew nuts, copra, cocoa, coconut oil, industrial diamonds, manganese, palm oil, rubber, tapioca and vanilla beans. These purchases would, however, be largely confined to the tropical and mineral-exporting regions and would therefore not alleviate the difficulties of the temperate agricultural countries such as the Argentine, Paraguay and Uruguay.

Measures to promote trade take time to become effective; the immediate aid extended by the United States Government is represented by loans and credits, granted mostly through the Export-Import Bank. Apart from the support given to local currencies, the purposes of the credits were to finance essential imports from the United States, particularly of machinery and transportation and construction equipment, and also to afford a means for carrying through certain internal development projects. In this connection it is of interest to mention the movement towards a wider industrialisation of the Latin American countries. Many of these countries have reduced or waived their import duties on industrial equipment and materials during 1940, either for particular types of production or for new manufacturing enterprises in general. At the same time these countries seek to intensify trade with each other by conclusion of commercial agreements and improvement of communications. The Argentine has negotiated agreements with Brazil, Chile and Uruguay. The difficulties are many and ratification is often slow, but in the spring of 1941 an accord was reached with Brazil which gave practical effect to the partial elimination of barriers against Argentine exports of wheat into Brazil and Argentine imports of cotton textiles (including bagging) from Brazil. At the same time the agreement provided for reciprocal credits of Pesos 50 million to expedite the exchange of export surpluses (in particular Argentine wheat and Brazilian coffee).

Foreign Trade of Latin American Countries.

In millions of national currency units		1939			1940		
		Exports	Imports	Balance	Exports	Imports	Balance
Argentina	Peso pap.	1,770	1,338	+ 432	1,629	1,499	+ 130
Bolivia	£	8.5	4.8	+ 3.7	12.9	...	...
Brazil	Milreis	5,615	4,983	+ 632	4,966	4,964	+ 2
Chile	Peso or	671	410	+ 261	697	507	+ 190
Colombia	Peso	177	183	— 6	166	148	+ 18
Costa Rica	$	9.1	16.9	— 7.8	...	...	...
Cuba	Peso	148	106	+ 42	127	104	+ 23
Ecuador	Sucre	167	147	+ 20	113	174	— 61
Guatemala	Quetzal	17	15.3	+ 1.7	13.8	12.7	+ 1.1
Haiti	Gourde	35	42	— 7	28	38	— 10
Mexico	Peso	914	630	+ 285	960	669	291
Nicaragua	Cordoba	8.3	6.4	+ 2	...	...	...
Paraguay	Peso or	13.2	12.6	+ 0.6	11.4	14.8	— 3.4
Peru	Sol	381	256	+ 125	406	319	+ 87
El Salvador	Colon	32	22	+ 10	30	20	+ 10
Uruguay	Peso	101	65	+ 36	110	74	+ 36
Venezuela	Bolivar	953	326	+ 627	861	311	+ 550

Brazilian exports shrank from Contos 5.6 million in 1939 to 4.9 million in 1940, imports remaining virtually constant at Contos 5 million. The government is attempting to improve the country's position by an industrialisation programme, two facets of which are the establishment of a modern steel mill and the building of a cellulose factory designed to eliminate 70 per cent. of Brazilian paper imports. In the **Argentine** a decline in exports and higher imports reduced the favourable trade balance from Pesos 432 million in 1939 to Pesos 131 million for 1940. In an effort to reduce the sterling balances held in London and economise dollar exchange, the Argentine removed virtually all restrictions on imports from the United Kingdom. Although most of **Chile's** pre-war trade was on a compensation basis, with Germany as leading partner, the country has been able to realise an export surplus amounting to gold Pesos 172 million, 1940 being a better year as regards both exports and imports than 1939, which was an extraordinarily poor year in Chilean trade. United States purchases to build up emergency reserves are a significant factor for copper and may become so for nitrates. In Peru also, United States metal purchases increased materially. Swollen tin exports from Bolivia, in excess of current production, occurred during the last months of 1940. Colombian trade with the United States kept up well, there being a significant improvement in economic conditions in the country as the year progressed. Coffee prices rose by 10 per cent. as a result of the coffee stabilisation agreement. The position of Venezuela, on the other hand, was adversely affected by curtailment of oil production and reduced sales of coffee to Europe. Foreign exchange accruing from exports during 1940 was estimated by the Banco Central de Venezuela at 14½ per cent. less than the 1939 figure. With the accumulation of dollar arrears, the Banco Central imposed drastic exchange control, which was later modified upon the announcement of stabilisation credits from the National City Bank of New York — almost the only loan of this kind obtained from a non-official credit institution during the year. Cuba, whose main product is sugar, suffered from the closing of European markets and from the rigid fixing of the Cuban quota for sugar on the United States market, which gives preference to sugar from the Philippines. During 1940 sugar exports shrank to less than 2 million tons, compared with normal post-depression sales of 2.5 million tons and a capacity of 5 to 6 million tons. Tobacco exports were also reduced, the British market for Cuban cigars having been closed. The United States, however, took larger amounts of manganese, vegetables and fruit, and the Cuban Government endeavours to mitigate the impact of adverse trade conditions by a policy of stimulating maize and rice culture and of building up light industries.

Other republics in Central America, although not unaffected by the war in Europe, are as a rule profiting from the rise in the national income of the United States, which is their main customer. From 1939 to 1940 Mexican exports to the United States increased by 35 per cent. and imports from the latter country by 16½ per cent. The main export items were newly mined silver and gold, followed by petroleum and its products. With the inauguration of a more conservative administration there was a large inflow of capital, reversing the outward movement estimated at Pesos 500 million during the oil expropriation crisis. The Mexican Government has announced that foreign capital will again be permitted to participate in oil exploitation.

Intensification of the war in Europe and measures taken in the United States and some other countries to retain essential supplies for domestic requirements have added to the difficulties already existing in the Far East, although the capacity of that area to find means of overcoming seemingly insurmountable obstacles to trade has once again made itself felt. For Japan

Japanese Foreign Trade.*

In millions of yen	Exports	Imports	Balance
1936	2,798	2,928	— 130
1937	3,319	3,955	— 636
1938	2,897	2,836	+ 60
1939	3,933	3,127	+ 805
1940	3,972	3,709	+ 263

* Including Formosa and Korea.

higher import and export values were recorded, but the increase was due principally to a rise in prices (as far as exports are concerned, in the price of silk, in the first place). While in 1938 62 per cent. of Japanese exports went to the Continent of Asia, more than 50 per cent. of imports were obtained from North America and Europe (37 and 14 per cent. respectively).

The export surplus in 1940 was only a third of what it had been in the previous year; and to judge from the detailed statistics available up to the end of September 1940 (since when they have no longer been published), the balance of trade with "devisen countries" was increasingly passive.

Japanese Trade Balance.

Export (+) or import (—) surplus in millions of yen	January-September		
	1938	1939	1940
Yen area	+ 387	+ 728	+ 891
"Devisen countries"	— 496	— 435	— 640
Balance . .	— 109	+ 293	+ 251

Already in the autumn of 1939 steps had been taken to reduce Japanese exports to the countries of the yen area (Manchukuo and North China), but the effect was mainly to increase the price of Japanese products in these countries. In the autumn of 1940 a series of new measures was adopted. Apart from exchange restrictions on the transfer of funds, an "adjustment fee" was collected in Japan to restrict exports, and at the same time the list of commodities for which official permission must be obtained prior to shipment to the yen-bloc countries was greatly enlarged. The supply of Japanese capital for the development of Manchukuo and North China was also curtailed. Moreover, Japanese control of trade in the occupied parts of China was intensified by means of officially sponsored trade associations or guilds composed only of Japanese and Chinese members.

The foreign trade of China with other countries than the Japanese Empire and Manchukuo would seem to have been on about the same level in 1940 as in the previous year. Recalculated in United States currency, recorded imports from these other countries totalled $260 million — a decrease of only 2¼ per cent. below the estimate for 1939. Exports to these other countries totalled approximately $189 million — an increase of 2¾ per cent. over the previous year. 30 per cent. of these imports came from and 50 per cent. of the exports went to the United States. The Chinese statistics of trade with Japan, Formosa, Korea and Manchukuo are known to be grossly incomplete, as may be seen from a comparison with the corresponding items in the returns of these other countries of their trade with China. Unofficial estimates put total Chinese exports at over Yen 1,000 million (instead of Yen 593 million according to the Chinese statistics) and imports into China at not less than Yen 800 million. Shanghai has retained its predominant position in the foreign trade of China: not less than one-half of Chinese imports and three-quarters of the exports pass through Shanghai.

No statistical information is available regarding the trade of the Far East with the U. S. S. R. or transport to Europe over the Siberian railway, but in view of the great distance such transport must, on the whole, be restricted to high-quality or otherwise valuable products. The trade of the United States with the U. S. S. R., which in 1940 was carried via Vladivostok, is shown by the following figures (from the United States statistics).

U. S. Foreign Trade with U. S. S. R.

In millions of dollars	U. S. Imports from	U. S. Exports to
	the U. S. S. R.	
1937	31	43
1938	24	70
1939	25	57
1940	21	87

Although American exports to the U. S. S. R. rose by $30 million from 1939 to 1940, they represented in the latter year only 2.2 per cent. of total U. S. exports. The two most important items in the list of exported commodities are metal-working machinery and refined copper. The active balance of the United States, amounting to over $65 million, was partly covered by Russian gold shipments of $31 million in 1940. The foreign trade monopoly in the U. S. S. R. is administered by the People's Commissariat for Foreign Trade, which maintains representatives of a semi-diplomatic character in foreign countries with which commercial treaties have been concluded.

The trade agreement between the U. S. S. R. and Germany of August 1939 (supplemented by a more detailed agreement of February 1940) aimed at an increase in the exchange of goods between the two countries to the highest level attained in any previous year. German imports from the U. S. S. R. reached their maximum in 1930, when they amounted to RM 430 million, and German exports to the U. S. S. R. in 1931, with a figure of RM 763 million. By 1938 the trade turnover between the two countries had fallen to only RM 80 million. It is believed that in 1940 U. S. S. R. exports to Germany reached the previous maximum of RM 430 million. Between the autumn of 1939 and the spring of 1940 the U. S. S. R. concluded a series of commercial agreements, especially with countries in the Danubian and Balkan regions and in Scandinavia. A commercial agreement with Bulgaria in January 1940 was followed by a trade agreement with Yugoslavia in May, with Hungary in September, and with Slovakia in December 1940. In the North, agreements were concluded with Finland in June and with Sweden and Denmark in September 1940. All these agreements fixed in detail the kind of commodities to be exchanged and the sums to which total deliveries should amount. The agreement with Sweden provided, moreover, for a credit of S. Kr. 100 million granted by Sweden and to be utilised especially in connection with deliveries of railway material.

No statistics have been published regarding the foreign trade of Germany since the war began. In a speech made by a Director of the German Reichsbank and published in December 1940 it was, however, explained that at the beginning of the war there was naturally a sharp decline in the foreign turnover, since more than one-half of Germany's pre-war imports came from overseas countries and from England and France. But, thanks to an intensification of trade with European countries, the volume of German foreign trade was gradually brought back to the pre-war level as regards both exports and imports. Germany's foreign trade balance at the beginning of the war was at first active; later on, heavy German purchases in all the accessible European countries led to an import surplus, although the German economy was able to maintain a considerable production for export in addition to its work for the armed forces. In the latter half of 1940 German imports from Holland, Belgium and France rose considerably, substantial stocks of raw materials which these countries had accumulated being partly transferred to Germany. The improvement in Germany's trade position was helped by the well-maintained foreign trade of the Protectorate of Bohemia and Moravia, which entered into a customs union with Germany as from 1st October 1940. In recent years the percentage distribution of Germany's trade within Europe has been as follows.

Germany's Foreign Trade
Percentage of Exports and Imports with Europe.

Year	Exports				Imports			
	Gt Britain and Eire	U.S.S.R.	Other European Countries	Total Europe	Gt Britain and Eire	U.S.S.R.	Other European Countries	Total Europe
1930	10.3	3.6	64.0	77.9	6.1	4.2	45.7	56.0
1931	11.9	7.9	61.2	81.0	6.7	4.5	44.7	55.9
1932	8.0	10.9	62.1	81.0	5.5	5.8	42.3	53.6
1933	8.6	5.8	63.6	78.0	5.7	4.6	44.0	54.3
1934	9.7	1.5	66.5	77.7	4.7	4.7	49.6	59.0
1935	9.1	0.9	63.2	73.2	6.4	5.2	50.0	61.6
1936	8.8	2.6	59.2	70.7	6.5	2.2	51.1	59.8
1937	7.5	2.0	59.7	69.2	5.9	1.2	48.5	55.6
1938	7.2	0.6	61.9	69.7	5.4	0.9	48.1	54.4
1939*	6.1	0.6	64.6	71.3	5.0	0.4	54.3	59.7

* 7 months.

Just before the war 65 per cent. of Germany's exports went to Continental Europe, from which Germany took 55 per cent. of her imports. Trade with the U. S. S. R. was negligible (½ per cent. of the total turnover). Besides the recovery of the Russian trade in 1940, a notable increase occurred in trade with Italy, which amounted in 1938 to 4 per cent. of total German imports and 5½ per cent. of total exports. Increased coal deliveries to Italy should be specially mentioned. Of the 12 to 13 million tons of coal annually imported into Italy about 65 per cent. was obtained in 1937 from Germany (principally by sea via Hamburg) and 16 per cent. from the United Kingdom. In 1940 British shipments were wholly replaced by deliveries from Germany. Total British exports of coal amounted to 36.5 million tons in 1938, of which 28.5 million were shipped to the Continent of Europe, mainly to the Scandinavian countries and Italy. The disappearance of British competition in most parts of the continent has opened the field for increased German exports.

In February 1941 an agreement was concluded between Germany and Italy providing for an exchange of goods to the value of RM 1 milliard annually;

at the same time it was agreed that for the duration of the war all deliveries of military importance should be continued without regard to equilibrium in the balance of payments or the position of the clearing accounts.

In Italy also, regular publication of foreign trade returns has been discontinued since the beginning of the war, but the global figures for 1940 have been disclosed. According to these figures imports increased by some Lit. 2.9 milliard to Lit. 12.9 milliard, about 30 per cent., this being the highest level reached since 1931 (except for the year 1937, when the necessity of replenishing stocks after the Abyssinian campaign swelled imports to a record figure of Lit. 13.6 milliard). Exports in 1940 amounted to Lit. 9.2 milliard, compared with Lit. 8.5 milliard in the previous year, thus increasing by 9 per cent. In the whole period 1931–40 the highest exports were attained in 1931 with a figure of Lit. 10 milliard, i. e. before the great depression had made its full effects felt in Italy. The passive trade balance rose from Lit. 1.5 milliard in 1939 to Lit. 3.7 milliard in 1940, which is below the previous record of Lit. 5.7 milliard in 1937. It is officially stated that the deficit in the trade balance was largely due to the payment of higher prices for imported goods and to the necessity of accumulating stocks. It is added that in the balance of payments the deficit on merchandise account was largely offset by certain active items, such as shipping freights (during the first five months of the year), and by a reduction in certain passive items, such as the service of Italian foreign loans, the transfer of which has been suspended since June 1940.

According to statistics compiled by the Confederation of Commerce 84 per cent. of the total volume of foreign goods entering Italy in 1938 arrived by sea, by the following routes:

Through Gibraltar	79.1 per cent.
,, Suez	5.5 ,, ,,
,, the Dardanelles	4.8 ,, ,,
,, the Mediterranean Basin	10.6 ,, ,,
Total	100.0 per cent.

Although the overseas trade of Italy came practically to a standstill upon her entry into the war, the loss thus sustained was partly counterbalanced by an increase in the traffic with Continental Europe, particularly with Germany, Switzerland, Sweden and Spain. During the last seven months of 1940 Germany took 41 per cent. of Italy's exports, providing some 47 per cent. of her imports. The exchange of goods between Italy and countries in the Danubian and Balkan regions seems also to have made further progress during 1940.

The following table summarises the trade returns of the Danubian and Balkan countries for 1939 and 1940. Not only value figures but also quantities (in weight) have been given; great increases having occurred in commodity prices, a comparison on the basis of value figures alone is no longer conclusive.

Foreign trade of Danubian and Balkan countries 1939 and 1940.

Countries	Value in millions of national currency units								Weight* in thousands of tons			
	Imports			Exports			Balance		Imports		Exports	
	1939	1940	% change	1939	1940	% change	1939	1940	1939	1940	1939	1940
Bulgaria	5,197	7,028	+ 35.2	6,065	7,019	+ 15.7	+ 868	− 9	389	383	544	996
Greece (Jan.-Oct.)	10,645	10,691	+ 0.4	7,140	8,127	+ 13.8	−3,505	−2,564	2,180	1,323	1,093	468
Yugoslavia	4,757	6,019	+ 26.5	5,521	6,680	+ 21.0	+ 764	+ 661	1,126	1,263	3,464	3,255
Hungary	489	598	+ 22.3	605	506	− 16.5	+ 116	− 92	2,863	3,287	2,856	2,019
Roumania	22,890	27,411	+ 19.8	26,809	36,783	+ 37.2	+3,919	+9,372	739	522	7,564	5,374
Turkey	118	69	− 41.7	127	111	− 12.5	+ 9	+ 42	735	357	1,135	659

* Excluding quantities expressed in heads, numbers and cubic metres.

Whilst higher values are recorded, except for the trade of Turkey and the exports from Hungary, the quantities exchanged are usually down. An extreme case of divergence between the tendencies revealed by quantities and values is that of the oil export from Roumania; the oil exported fell from 4.2 million tons in 1939 to 3.5 million tons in 1940, but its value, as shown in the trade returns, rose from Lei 11.2 milliard in 1939 to Lei 23 milliard in 1940, constituting in the latter year 60 per cent. of the total Roumanian exports.

Apart from the obstacles caused by warfare and blockade, the decline in the trade of south-eastern Europe was due to bad harvests in most of the countries and also to measures taken by the governments to retain essential commodities for home consumption. In the approach to the problems of foreign trade a great change has occurred: while up to the end of August 1939 the aim of the commercial policy was to achieve a "favourable trade balance", the attitude thereafter may be indicated by the formula: "imports precede exports". Instead of import restrictions of various kinds, export quotas and export prohibitions have been imposed and the accumulation of free "devisen" is no longer regarded as a major objective. In Bulgaria import credits granted by banks have in many cases been guaranteed by the government; two official companies have been created; the export of a long list of articles produced locally or imported has been prohibited. In Yugoslavia a Directorate for Foreign Trade was established in August 1940 and the Minister of Commerce was authorised to enforce obligatory cartels for special branches of foreign trade.

In the early months of 1940 attempts were still made to import raw materials from overseas markets. Traffic in the Mediterranean was, however, much hampered from the very beginning of hostilities in Europe; it became extremely difficult after the entry of Italy into the war and well-nigh impossible after the outbreak of the Italo-Greek war. Among the raw materials which threatened to become particularly scarce textile fibres were of the greatest importance, the Danubian and Balkan countries having developed their own

Imports of cotton and cotton tissues by Balkan countries.

In thousands of tons	Raw cotton	Cotton yarns	Cotton tissues
Yugoslavia			
1929	7.5	9.9	10.4
1938	21.6	13.9	2.5
Roumania			
1929	3.3	24.0	8.8
1938	20.8	14.0	0.8
Bulgaria			
1929	1.9	6.4	1.3
1938	10.3	1.9	0.9
Greece			
1929	2.9	0.5	6.1
1938	2.5	0.5	3.2

textile industries, as may be seen from the change-over which has occurred in the import of cotton tissues and raw cotton.

A substitute for imported cotton was found to some extent in unexpectedly large deliveries of "Ersatz-Fiber" from Germany and Italy. Mention should also be made of the increase in the local growth of cotton in Bulgaria, Greece and Turkey. The last-mentioned country was even able to supply raw cotton for export, particularly to Yugoslavia and Roumania. In general, trade has been on the up grade in recent years between the various countries of the south-eastern area, which are more diversified in their production than, for instance, the countries in Latin America. Hungary is a supplier of industrial goods (including machinery), Roumania of oil, Bulgaria of coal, Yugoslavia of several metals and minerals and Turkey of wool and cotton. Moreover, local deficiencies have often been relieved by increased trade with the U. S. S. R. since the conclusion in 1940 of a series of commercial agreements, which embodied provisions for 100 per cent. compensation, invoicing of deliveries in local currencies (although U. S. S. R. deliveries are based on U. S. dollars convertible into local currencies at official rates), and certain margins within which the balance of trade may temporarily move.

Up to the spring of 1940 the products of the countries in south-eastern Europe were eagerly bid for by both Germany and the United Kingdom, which offered good prices and favourable conditions of payment. Even before the events of the spring and summer Germany was the most important partner, except in her trade with Turkey, which dropped in value to one-sixth of what it had been in the previous year. One-half of Hungary's foreign trade was with Germany; 18 per cent. with south-eastern Europe; 12 per cent. with Italy; and 5 per cent. with Switzerland, more distant markets being almost excluded. There was a marked increase in imports of ready-made articles and machinery as well as of coal and coke. The export of farm products fell by one-quarter despite higher prices, and there was a decline of 10 per cent. in the value of exported industrial goods — in some cases for want of raw materials and in others because the industry was occupied with home orders for armaments. The net result of the year's trade was a deficit amounting to around Pengö 90 million — the highest deficit in the balance of trade since the years 1927 and 1928, the period of great imports of capital into Hungary. In Yugoslavia the volume of exports was practically the same as in the previous year, while the volume of imports rose by 12 per cent. Germany, together with the Protectorate of Bohemia and Moravia, took 40 per cent. of the exports and provided 65 per cent. of the imports, followed by Italy with about 13 per cent. both ways. Roumania's foreign trade in 1940 was swollen by sharp increases in prices; the average price rose by 70 per cent. per ton of goods imported and by 93 per cent. per ton exported. For trade with Germany, which after the events in the summer of 1940 accounted for more than one-half of Roumania's imports and exports, the traffic on the Danube is of outstanding importance. Bulgaria, being one of the few countries in Europe with a good harvest in 1940, was able to increase her exports of wheat and rye (by about 7 per cent.) and also of coal and iron ore, but sold less tobacco and fruit. More was imported of industrial articles but less of raw materials. Germany's share of the total trade fell from 65 to 60½ per cent., but the share of Italy rose from 6 to 8½ per cent. and that of the U. S. S. R. from zero to 3¾ per cent. Greece increased her imports of minerals, oil and chemical products as well as her exports of currants, tobacco and olive oil, strengthening in particular her trade with the United States, which in the first nine months of the year took nearly 20 per cent. of exports and provided 10 per cent. of imports. In the same months, compared with those of the previous year, exports to Germany rose from 34 to 44 per cent. of the total, while imports from Germany fell from 30 to 24 per cent. The foreign trade of Turkey declined heavily from 1939 to 1940, exports being reduced by 12 per cent. and imports by 42 per cent. The fall was above all due to the sharp reduction in trade with Germany after the non-renewal of the commerce and payments agreements between the two countries in 1939.

The authorities in Switzerland no longer publish details regarding the composition of foreign trade or its distribution among different countries, but the global figures of values and quantities of imports and exports give some indication of the general tendencies.

Foreign Trade of Switzerland.

Period	Value In millions of francs			Weight in thousands of tons	
	Imports	Exports	Balance	Imports	Exports
1938 — 4th quarter	428	384	— 44	1,764	152
1939 — 4th quarter	623	325	— 298	2,551	94
1940 — 1st quarter	614	330	— 284	2,095	114
2nd quarter	580	306	— 274	1,981	92
3rd quarter	251	292	+ 41	741	115
4th quarter	409	387	— 22	1,296	179
1941 — 1st quarter	447	327	— 120	1,224	150
1938 — full year	1,607	1,317	— 290	7,379	611
1939 — „ „	1,889	1,298	— 592	8,660	539
1940 — „ „	1,854	1,316	— 538	6,114	499

In the development of foreign trade since the war began it is possible to distinguish two different phases. From September 1939 to the spring of

1940 successful efforts were made to increase imports in order to accumulate stocks, especially of raw materials. Then came a sudden decline in the summer of 1940: during the third quarter imports fell in weight to only one-third of what they had been in the previous winter; and, although there was a certain recovery in the autumn, the quantities then imported were only about two-thirds of the normal volume — indicating reduced imports of raw materials. As a result of the general rise in import prices the reduction in the value of imports by 2 per cent. for the year as a whole corresponds to a setback of 30 per cent. in volume.

The export trade shows a somewhat different development. From September 1939 to the summer of 1940 there was a certain reduction in the weight of goods exported (partly because of export prohibitions in Switzerland and partly because many foreign countries prohibited the import of Swiss products of a luxury character), but prices were higher, so that in value exports still showed an increase. From the third quarter of 1940 a notable advance occurred in the volume of exports — an indication of a change in the structure of the export trade. Normally, Swiss exports consist of highly manufactured products — mostly ready-made articles of consumption (textiles, watches, etc.) as well as machinery and instruments usually of high quality. While in some of these lines exports declined, an important new category was added: export of goods for general consumption, such as cattle and dairy products, which are heavier in weight in relation to their value.

Foreign Trade of the Northern Countries in 1939 and 1940.

In millions of national currency units	Imports	Exports	Trade Balance
Denmark			
1939	1,740	1,578	— 162
1940	1,374	1,508	+ 134
Finland			
1939	7,573	7,710	+ 137
1940	5,180	2,980	—2,200
Norway			
1939	1,366	808	— 559
1940	945	612	— 333
Sweden			
1939	2,499	1,889	— 610
1940	1,999	1,338	— 661

In the three Scandinavian countries imports were exceptionally high up to the spring of 1940, when the extension of the war to Norway and Denmark radically changed their foreign trade position. If the average for the years 1936–38 be taken as 100, the import volume of Sweden in January 1940 reached the high figure of 142, from which it fell to about 50 in the latter half of the year. The export volume, which in the first quarter of the year had stood at 95, fell to a low of 40 in the following June, recovering to about 50 in the latter half of the year. Normally about 40 per cent. of total Swedish exports consisted of timber, wood-pulp and paper, of which more than three-quarters was sold to the British and extra-European markets, now no longer accessible. New trade agreements were concluded with a number of countries in Europe as well as with the U. S. S. R., and it proved possible to arrange for a limited number of supplies via the North Sea. No details are published regarding the distribution of trade among foreign countries, but the following percentages give an indication of the change which has occurred: while in 1936–38 the Continent of Europe accounted for 53 per cent. of both Swedish imports and exports, in the twelve months May 1940 to April 1941 it provided 83 per cent. of the imports and took 91 per cent. of the exports.

In Norway also the volume of imports and exports fell heavily after the events in the spring of 1940, although measures were taken to increase German purchases of forestry products, fish and minerals. Denmark, for the first time since 1914, had an export surplus in 1940, due to large exports to Germany not only from current production but also from the stocks of cattle, pigs and poultry which had to be reduced when feeding stuffs could no longer be imported from overseas countries. In judging the value of the foreign trade figures it must be borne in mind that during 1940 export prices rose by an average of 27 per cent. and import prices by 62 per cent.

Finland's foreign trade in 1940 was affected not only by the war with the U. S. S. R. and the cession of territory which normally provided about 12 per cent. of the exports but also by the extension of the great war to Denmark and Norway, as a result of which Finland was separated from her main import and export markets in the British Isles. Traffic through Petsamo, of which about one-third was reserved for Sweden, accounted for only 7,000 to 8,000 tons a month for imports and the same for exports, and was, moreover, subject to certain interruptions. Efforts have been made to increase the exchange of goods within Europe: Germany has become the most important partner, taking well over 50 per cent. of Finnish exports, compared with 15 per cent. in 1938. With regard to the value figures for Finnish trade, it should be borne in mind that they do not include deliveries of a military character and that for 1940 import prices rose on an average by 60 per cent., while export prices increased by only 20 per cent. The recorded deficit in the balance of trade was FM 2,200 million in 1940, as compared with an export surplus of FM 137 million in the previous year. More foodstuffs (especially wheat and rye) were imported in 1940, while the export of agricultural products (butter, eggs, etc.), which in 1939 had attained over FM 600 million, was prohibited. Over 80 per cent. of Finland's peacetime exports consisted of timber, pulp and paper, i. e. products derived from forestry, one of the few sources of raw materials of which the Continent of Europe has a surplus above its ordinary requirements.

The foreign trade of Holland in the first quarter of 1940 was characterised by a large import surplus:

Imports	Fl. 408 million	(of which	Fl. 77	million	was from Germany)
Exports	Fl. 217 ,,	(,, ,,	Fl. 32	,,	was to Germany)
Import surplus	Fl. 191 ,,	(,, ,,	Fl. 45	,,	were in relation to Germany).

Foreign Trade of Holland.

Monthly in millions of florins	Imports		Exports	
	Total	From Germany	Total	To Germany
1940 May	61	11	45	10
June	61	6	27	25
July	41	20	30	25
August . . .	54	30	44	39
September .	51	32	47	40
October. . .	62	40	59	49
November. .	64	41	47	40
December. .	60	39	45	35
1941 January. . .	62	43	33	22
February . .	60	42	43	32

No statistics are available for the month of April, but customs receipts for that month were rather high (amounting to Fl. 11 million, compared with an average of Fl. 10 million for the first three months of the year), and it is therefore possible to conclude that at least imports were well kept up.

The accompanying figures indicate the trend of trade from May 1940.

In the ten months May 1940 to February 1941 trade was mainly with Germany.

Foreign Trade of Holland May 1940–February 1941.

In millions of florins	Imports	Exports	Balance
Trade with Germany	303	317	+ 14
,, ,, other countries	272	102	— 170
Total foreign trade	575	419	— 156

Imports from Germany increased from October 1940, probably in connection with increased supplies of raw materials for Dutch industries, which early in 1941 received large German orders.

During the first four months of 1940 the imports of the Belgium-Luxemburg Union amounted to B.fcs 8,395 million and the exports to B.fcs 5,887 million, leaving an import surplus of B.fcs 2,508 million. The following figures show the foreign trade up to September 1940.

For the last quarter of the year no figures of foreign trade have been published, but the customs receipts for that quarter amounted to B.fcs 159 million, compared with 78 million in the previous quarter, so the conclusion may be drawn that trade recovered somewhat from the low level of only 10 per cent. of normal which obtained in the summer and early autumn of 1940.

Belgium-Luxemburg.
Trade with Germany May-October 1940.

In millions of B.fcs	Imports	Exports
1940 May	661	1,057
June.	72	8
July	159	31
August	141	184
September	215	136

United States trade with France.

In millions of U. S. dollars	1938	1939	1940
U. S. exports to France . .	134	182	252
U. S. imports from France	54	62	36
U. S. export surplus . . .	80	120	216

For France no foreign trade figures have been published since the outbreak of war in 1939, but the magnitude of France's trade with the United States in recent years may be seen from the data taken from the U. S. trade returns.

Of U. S. exports to France in 1940 $205 million were shipped in the period January to May and only $47 million in the last seven months of the year.

Since the autumn of 1940 France has concluded commercial agreements with Switzerland (provisional agreement of 23rd October 1940), with Germany (compensation agreement of 14th November 1940) and with Finland (payments agreement of 28th February 1941). The provisional agreement with Switzerland covers only commercial transactions and will be supplemented later by a general payments agreement under negotiation. The compensation agreement with Germany applies to the occupied and non-occupied zones in France and to the French colonies. The Franco-German compensation agreement was extended to French-Belgian payments in January 1941, and to French-Dutch payments as well as French-Luxemburg payments in the following month. In the agreement with Finland provision has been made for the possible employment of balances in relation to third countries. The compensation agreement with Portugal (from 1934) and that with Spain (from January 1940) have remained in force.

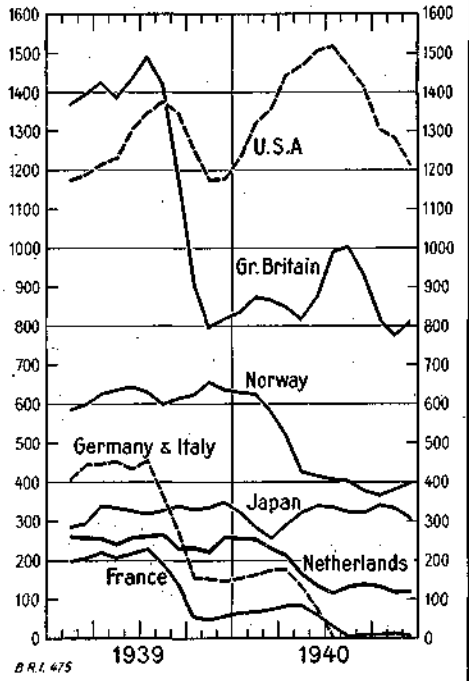
With other countries with which commercial relations are maintained such trade as is possible usually takes the form of private compensation.

No statistics of the foreign trade of Spain have been published since 1936, except for the period August–December 1939, when the total in foreign trade amounted to 582 million gold pesetas with an adverse balance of 103 million gold pesetas. For the sake of comparison it may be mentioned that for the whole year 1935 the corresponding figures were a total trade of 1,458 million gold pesetas with an adverse balance of 292 million gold pesetas. The foreign trade of Portugal in 1940 was characterised by an increase in the value but a decline in the weight of both imports and exports, indicating a considerable rise in prices of almost all goods included in the foreign trade.

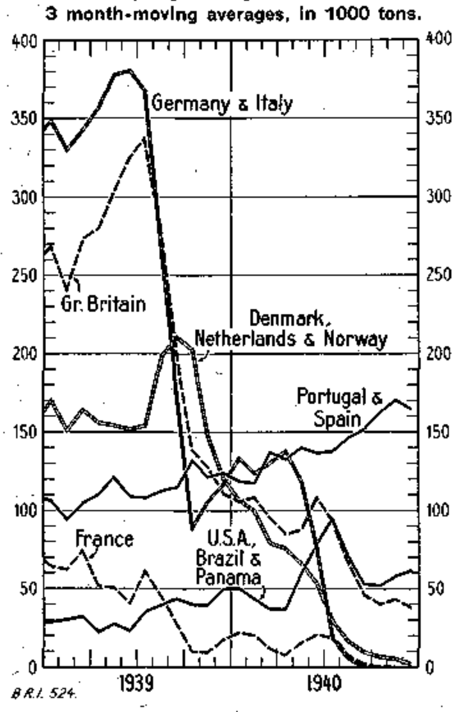
Foreign Trade of Portugal 1938–1940.

Period	Value in millions of escudos			Weight in thousands of tons	
	Imports	Exports	Balance	Imports	Exports
1938	2,280	1,135	— 1,145	2,386	1,538
1939	2,067	1,339	— 728	2,292	1,469
1940	2,524	1,613	— 911	1,842	1,139

Vessels cleared from U. S. Ports.
Monthly – net registered tonnage.
3 month-moving averages, in 1000 tons.



Vessels entering the Port of Lisbon.
Monthly – gross registered tonnage.
3 month-moving averages, in 1000 tons.



The decline in imports was primarily due to reduced shipments of coal and anthracite, though there were also smaller imports of iron and steel, certain chemical products, newsprint and automobiles. More wool and cotton, vegetable oil and wheat were imported. The decline in exports extended to almost all Portugal's products but was most notable in wine, resin and pyrites, the latter being affected by the fall in exports to France. There were, however, larger exports of cattle and pigs (to Spain) and of certain textile goods.

From the summer of 1940 Lisbon, together with some Spanish ports, Genoa for occasional shipments to Switzerland, Gothenburg and Petsamo in the north and the Siberian railway to Vladivostok, *formed the only openings for the Continent of Europe to the outside world.* The shrinkage of seaborne traffic is indicated in the accompanying graphs.

The position of Europe in world trade before the present war may be seen in the table on the next page, reproduced from a study on "Europe's Trade" published in 1941 by the Economic Intelligence Service of the League of Nations. For the world as a whole the imports recorded in the trade returns exceed the exports chiefly for the reason that freight charges, etc. are included in the import but not in the export valuation (imports being valued at their c.i.f. and exports at their f.o.b. prices).

The amounts shown in the table as trade of Europe comprise, besides goods exchanged with other continents, the trade between the different European countries; and similarly the figures for the "rest of the world" include the "foreign" trade between and within other continents. Of the total

Europe and the Rest of the World: Composition of Trade in 1937.

In milliards of dollars	Imports	Exports	Balance
Europe, excluding the U. S. S. R.			
Foodstuffs and live animals	4.2	1.9	— 2.3
Materials, raw and partly manufactured	7.2	3.1	— 4.1
Manufactured articles	3.8	6.6	+ 2.8
Total	15.2	11.6	— 3.6
Rest of the world			
Foodstuffs and live animals	2.3	3.8	+ 1.5
Materials, raw and partly manufactured	4.1	6.6	+ 2.5
Manufactured articles	6.1	3.4	— 2.7
Gold and silver (from producing countries)	—	0.7	+ 0.7
Total	12.5	14.5	+ 2.0
World total	27.7	26.1	— 1.6

world trade thus calculated, Europe accounts for about one-half (somewhat more of imports and somewhat less of exports). With one exception (United Kingdom) European countries dispose of the bulk of their exports in Europe and obtain from other European countries the bulk of their imports; the trade which the different industrial countries in Europe conduct with each other far exceeds in value the exchange of goods between the industrial and the predominantly agricultural countries. In 1937 Europe as a whole (excluding the U. S. S. R. but including the British Isles) obtained $7.5 milliard (or 49 per cent. of total imports) from other continents and consigned $4.3 milliard (i. e. 37 per cent. of total exports) to other continents. Europe imports foodstuffs and raw materials against the sale of manufactured products, covering the net balance, which in 1937 came to $3.2 milliard, by income from her foreign investments and a surplus of services rendered by her mercantile marine, banks, hotels, etc. On account of those differences in valuation which creep into trade returns, the figure of $3.2 milliard just mentioned is slightly lower than the corresponding figure of $3.6 milliard shown in the above table as the balance between European imports and exports; but the composition of this balance as given in the table serves to indicate the nature of Europe's commercial relations with other continents.

Of the European exports to other continents, amounting to $4.3 milliard in 1937, $1.7 milliard were shipped from the United Kingdom and $2.6 milliard from the rest of Europe. Of the total European imports in the same year, amounting to $7.5 milliard, $3.3 milliard went to the United Kingdom and $4.2 milliard to the rest of Europe.

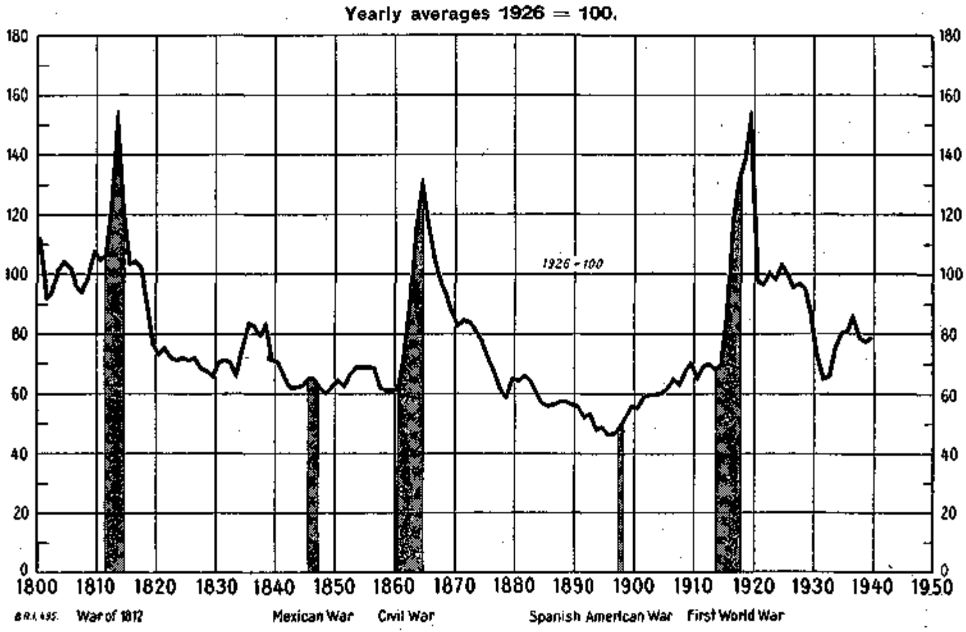
The situation as it has developed during the present war has also cut off trade between the British Isles and the Continent of Europe. The main results of this and other obstacles to normal commercial relations are the increased importance of Germany in the foreign trade of Continental Europe, the concentration of British trade on the rest of the Empire and the United

States, a change-over in the trade of the United States as regards both direction and composition of exports, the loss of European markets to the rest of the world (which particularly affects South America), and finally an increased interchange of goods between the different partners of the yen area in the Far East. Whatever measures may be taken to find alternative markets and sources of supply, the drastic severance of trade exposes the world economy to a damaging distortion with repercussions difficult to foresee. In no sector is the dislocation of the familiar pattern more violent than in the sphere of foreign trade, which can no longer be based on considerations of quality and price but must be directed according to political expediency and wartime possibilities. Some of the effects may indeed be of a lasting character. Europe (and especially the United Kingdom) is losing part of its foreign investments, now mobilised for war purposes; the future European trade will also be affected by the movement towards industrialisation in South American and other countries, which already received an impetus during the last war. In some respects these changes may be to the advantage of certain non-European countries, but the experience of the two decades between the last and the present great wars seems to have shown conclusively that the world's large producers of raw materials and foodstuffs benefit, above all, from a high level of prosperity in the main industrial countries and not least in Europe.

3. PRICE MOVEMENTS.

Wars of any importance have in the past always been accompanied by increases in commodity prices. It is sufficient to cast a glance at developments

Wholesale Prices in the United States since 1800.
Yearly averages 1926 = 100.



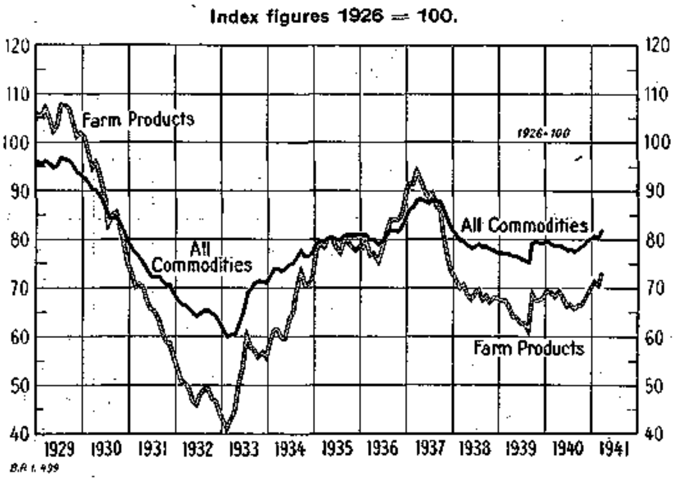
According to U. S. Department of Labor.

since 1800 to find an almost dreary repetition of rising prices during the years of war, followed by the difficult process of downward adjustment in the post-war period.

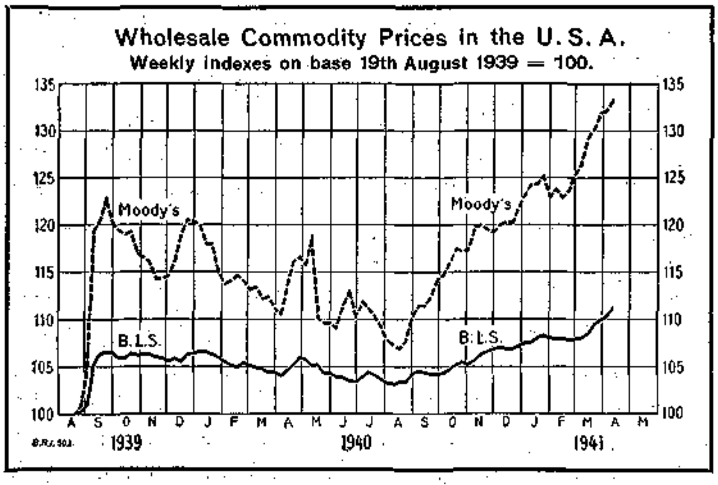
Commodity prices in the present war have risen steeply in a great number of countries but the upward movement has not been equally pronounced in all cases or even altogether general. The world markets for raw materials and foodstuffs, the movements of which are most typically reflected in the price indexes of the United States, did not participate to any appreciable extent in the rise in prices during the first year and a half of the present war; and in Europe Germany succeeded in keeping prices relatively stable by a comprehensive control, which did not need to be improvised under the pressure of war conditions since the basis for it had been laid already in 1936. But, as far as world markets are concerned, the stiffening of prices which began to make itself felt from the summer of 1940 gathered momentum in the spring of 1941; and in Germany there is also evidence of a distinct rise in prices of a limited range of non-essential commodities which have not been made subject to the full intensity of the price control.

By the end of 1940 the general level of wholesale prices in the United States had risen by only 6 per cent. since the outbreak of the war; wholesale prices were still well below the peak reached in the short-lived boom of 1937; and prices of farm products were generally much lower than in 1937, when supplies were relatively small after the droughts of 1934 and 1936 and when exports were larger than they have been since the present war began.

Wholesale Prices in the United States and Prices of Farm Products.
Index figures 1926 = 100.



The relative stability in the weighted average of nearly 900 price series which enter into the Bureau of Labor Index may, of course, cover substantial changes in the prices of particular commodities. In general, prices of basic commodities — as often happens — have changed more than prices of finished goods. There have been two periods of rapid advance: one in the autumn of 1939 and another in the autumn of 1940, the latter continuing with increased strength in the first half of 1941. The Moody's Index in the following graph (compared with the Bureau of Labor Index) is an index of 15 staple commodities, the prices of which are quoted in highly organised and sensitive markets.



Immediately after the outbreak of the war there were many in the United States who expected a strong export demand for raw materials, and prices hardened. Towards the end of 1939, however, it was clear that these expectations would not be realised, or at least not in the near future, and a decline in prices resulted. The second advance in the autumn of 1940 seems to have been primarily connected with domestic developments in the United States, i. e. with the rapid rise in industrial production and the simultaneous increase in national income payments, the latter having risen by 8 per cent. from the summer of 1939 to the beginning of 1941. Since the consumption of industrial raw materials in the United States appears to have risen to fully one-half of the world output, conditions in that country are decisive as regards movements on the relatively free markets outside Europe, on which the majority of prices are still determined by the interplay of supply and demand. Steps have, however, been taken to influence the volume of production (and thus supply) as well as consumption and the laying-up of stocks (affecting demand). The following factors have been of outstanding importance for the actual price movements:

1. Such international restriction schemes as have remained in force since the outbreak of the war have all along the line been considerably eased in their application. The production quota for rubber, which in the first half of 1939 had been 50 per cent. of the basic quotas, was gradually raised to 100 per cent.; in the case of tin the increase was even greater: from 40 per cent. before the outbreak of the war to 130 per cent. from July 1940.

2. The supply, especially of cereals, was at the same time increased by good harvests in 1940 in most extra-European producing areas. Wheat and cotton crops in the United States were above average; in Canada the wheat crop was of record proportions, and the wheat, linseed and maize crops in the Argentine were exceptionally good. The supply of most agricultural products is, of course, largely dependent on weather conditions; but for other basic materials there was a repetition of the experience from 1936–37, that in response to growing demand production could be extended within a relatively short time.

3. The total demand for raw materials has been affected by the disappearance first of German purchases and then, from the middle of 1940,

of almost the whole demand from the Continent of Europe. The German Institute for Business Research has estimated, on the basis of the trade figures for 1937, that the share of the Continent of Europe in the export of industrial raw materials and foodstuffs from extra-European countries may be put at about 30 per cent. of the total. The disappearance of this demand is no doubt the main cause of the comparative stability of raw-material prices on the world markets.

4. The need of finding compensation for the loss of the European markets has been one of the main reasons for a number of measures taken by governments in the United States and other overseas countries to sustain prices and, if possible, to find alternative outlets for surplus production. Some of the measures have been adopted under agreements between several governments, a typical example being the coffee agreement concluded in November 1940, establishing an import quota arrangement between the United States and 14 Latin American governments (see page 61). Part of the lending to Latin American countries by the Export-Import Bank and the Stabilization Fund of the United States must also be regarded as assistance to these countries to overcome the difficulties caused by the loss of export trade.

The United States has, in addition, tried to direct her own purchases of raw materials to the sister republics in Latin America. In this connection reference must be made to action taken through the Reconstruction Finance Corporation, which disclosed in a report published in May 1941 that the Federal Government had spent or contracted to spend about $1 milliard on the accumulation of rubber, tin and other materials not produced in the United States. This work is handled by special subsidiaries of the Corporation such as the Rubber Reserve Co. and the Metals Reserve Co.; $250 million will go to Latin America mainly for the purchase of reserves of copper, tin and rubber. Likewise the government of the United Kingdom, in its bulk purchases of materials within the Empire, has sought as far as possible to provide compensation for the loss of other export trade. Of certain colonial produce, such as cocoa, the government has bought the whole crop, although only part can actually be used; this method of purchasing has been designed to prevent destitution in territories which in the past depended largely on markets in the Continent of Europe.

5. Among the measures taken by governments in their own markets may be mentioned the support given to wheat and cotton in the United States through the laying-up of government stocks (partly as reserves for military needs) and the fixing of increased loan rates (up to 85 per cent. of the so-called parity prices of the five basic farm crops — cotton, maize, wheat, rice and tobacco. The 85 per cent. loan plan is designed to give the farmer, together with other advantages, the same purchasing power, in terms of non-farm products, as he had in 1909–1914). Loans to the farmers are granted by the Commodity Credit Corporation, which was formed in the autumn of 1940 with "powers to buy, sell, lend upon or otherwise deal in such commodities as may seem for the best interest of the recovery programme". Minimum prices have been fixed for wheat in Canada and the Argentine, and in both these countries the governments have laid up important stocks.

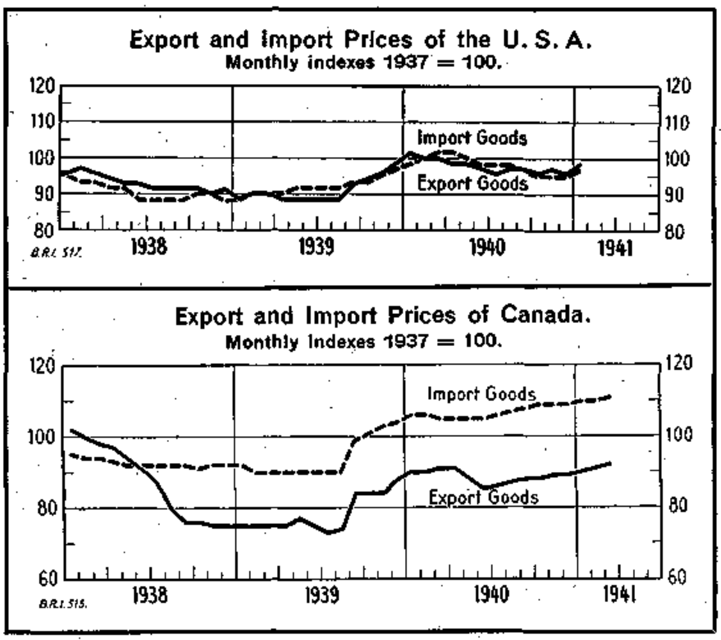
6. *The bulk purchases by the United Kingdom Government have not been* restricted to the British Empire, but within the Empire arrangements have in many cases been made for the duration of the war and even for longer periods. Thus the government has bought the wool-clips of New Zealand and Australia for the duration of the war and one year after at a price about 30 per cent. over pre-war quotations. The agreement was later extended to South Africa. In this connection it may be mentioned that under an Anglo-American wool agreement in the autumn of 1940 arrangements were made for shipment of 250 million pounds of Australian wool to the United States for storage. There have been fears that collaboration between the governments of the United States and the United Kingdom would result in preferential treatment for certain areas to the detriment of producers elsewhere. Increased consumption in the United States seems, however, to have generalised the demand for basic materials, so that, apart perhaps from certain agricultural products (such as wheat and cotton), divergencies within the overseas markets are less likely to occur, except in so far as scarcity of shipping facilities may give advantages to certain regions more favoured geographically.

7. Price movements outside Europe are increasingly dominated by the expansion of industrial production and the rise in national income in the United States, where shortages have already appeared in certain lines of commodities required by the defence industries and tendencies to price rises have been noticeable. In order to keep the situation under control the United States Government has taken steps to increase available supplies, to fix priorities in favour of defence industries and to restrict demand by development of substitutes and adoption of higher taxes. In April 1941 it established an Office of Price Administration and Civil Supply, entrusted not only with the task of preventing a rise in prices as a result of market conditions caused by diversion of large segments of the nation's resources to the defence programme, but also of stimulating provision of the necessary supply of materials and commodities for civilian use in such a manner as not to conflict with defence requirements of the United States and foreign governments.

No special powers have been granted to the new Office, which, however, may avail itself of the powers of the old War Industries Board set up in the last war and reincorporated in the Selective Service Act of 19th April 1941. These are mandatory powers for producing defence materials and may be used to secure control of prices, for it is recognised that the government cannot get sufficient production if price levels are not stabilised; the main sanction for non-compliance with price schedules consists in authority to take over a private plant. It is also possible that the Office may be able to obtain an injunction in equity against firms which contravene arrangements with regard to prices and priorities. It seems, however, as if the intention were to come to voluntary arrangements with private industry, involving a far-reaching stability of prices. The first formal priorities were established at the end of February 1941 (before the Office of Price Administration and Civil Supply had been formed); they pertained to machine-tools and aluminium; before that there were, however, informal priority arrangements for these and other products. The first action taken by the new Office was when steel prices were frozen on 16th April 1941 at levels prevailing during the first quarter of the year.

The price policy of the United States has hitherto been of a twofold character: on the one hand, measures have been taken to support the prices of farm products; on the other hand, control has been imposed to prevent prices of industrial materials from rising too steeply. So far, the cost of living has remained relatively unaffected by the upward movement of prices and wages in certain industries; the statistics show a rise in living costs of only 1 per cent. from the summer of 1939 to March 1941.

The stability in the price structure of the United States is also found in the movements of import and export prices, which have remained in close association in recent years.

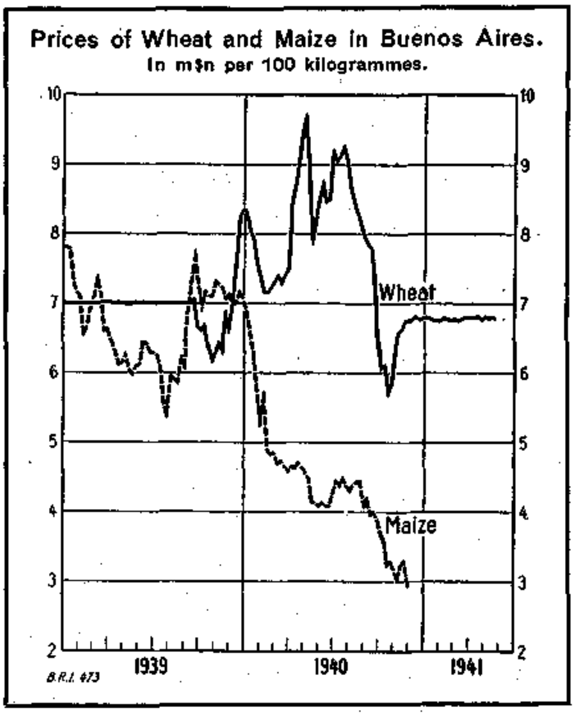


In Canada the general price level rose by some 12 per cent. in the autumn of 1939, the Canadian dollar having fallen in relation to the U. S. dollar by 10½ per cent. at the outbreak of the war. The growing discrepancy between import and export prices since the beginning of 1938 is principally due to the weakness of the price of wheat after the abundant crops.

Price movements in some Latin American countries are shown in the table. In Mexico and Venezuela both wholesale prices and cost of living have remained remarkably steady since the summer of 1939. In most of the Latin American countries a rise in the price level has, however, been caused by increased cost of imports, partly in connection with buying in the United States instead of in Europe. The prices of export goods have naturally suffered

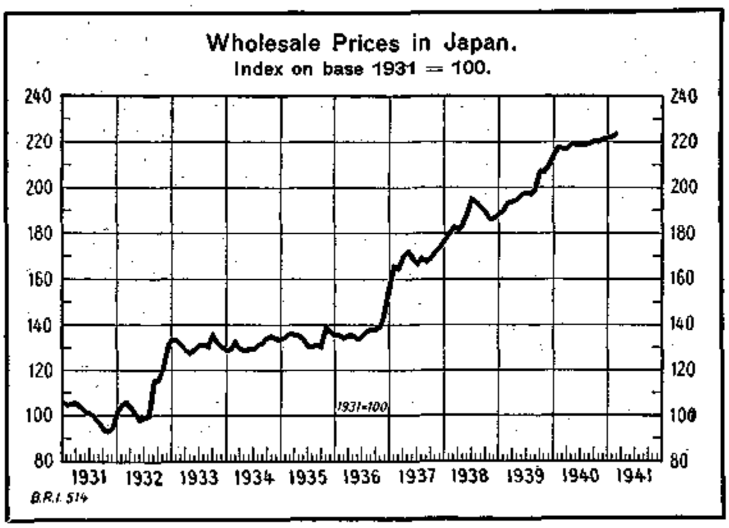
Price movements
in certain Latin American countries
from August 1939 to the end of 1940.

Index figures August 1939 = 100	Wholesale prices	Cost of living
Argentine	119	101
Chile	113	116
Colombia	—	93
Mexico	97	100
Peru	120	111
Uruguay	—	107
Venezuela	Nov. 103	Nov. 94



through the cutting-off of European demand, but in the spring of 1941 higher consumption in the United States helped to strengthen prices of coffee, sugar and a number of other commodities. In the Argentine a record crop resulted in an almost catastrophic fall in the price of maize in 1940, especially as existing facilities for storage were altogether insufficient.

The relative stability of raw-material prices on the world markets was of help to Japan in the efforts made during 1940 to check the advance in commodity prices in that country by the imposition of stricter control. In the three years from the summer of 1936 to the summer of 1939 the general level of wholesale prices in Japan had risen by 50 per cent., and as a result of the outbreak of war in Europe a further sharp increase of about 10 per cent. set in during the last four months of 1939.



The slowing-down of the upward movement from the beginning of 1940 had been chiefly due to the establishment of official prices for an increasing number of commodities. It is, however, emphasised in Japan that mere price-fixing will remain relatively ineffective as long as it proves impossible to secure adequate supplies, especially of daily necessities and important industrial raw materials. Measures have, for instance, been taken to increase the production of coal by the granting of subsidies. War conditions, however, make it difficult to increase output generally. The index of industrial production, published up to the end of September 1940, showed rather a decline in output during the first nine months of 1940 compared with those of the previous year. In relation to other partners of the yen area, measures have been taken to prevent an excess of exports of Japanese goods to Manchukuo and North China, where the rise in prices has been *even greater than in Japan.*

In the United Kingdom the initial advance of prices in the months immediately following the outbreak of war slowed down in 1940.

Price Movements in the United Kingdom.

Indexes on base of August 1939	Aug. 1939	Dec. 1939	Dec. 1940	March 1941
Wholesale prices* . .	100	124	151	154
Retail food prices . . .	100	113	125	122
Cost of living	100	112	126	127

* Board of Trade Index.

Apart from the impact of the heavy budget deficit and price developments on the world markets (where, as shown above, relatively slight increases have occurred), the main factors influencing British prices of imported commodities have been the lowering of the exchange value of the pound by 14 per cent. in September 1939, higher costs of transport, changes in the sources of supply, and the government's buying policy. On the whole, government purchases have been determined more by the need of securing adequate supplies than by considerations of price. This applies also to purchases of home-produced commodities, the prices of which have been influenced by increased costs, since rates of wages as well as prices of materials, equipment and transport have risen, while net profits have rather shown a tendency to fall. Prices of farm products showed a rise of 66 per cent. between August 1939 and September 1940. A large part of this increase was due to the raising of the minimum weekly wage rates of agricultural labourers by an average of 12s. to 48s. in July 1940, but another factor was the encouragement given for an extension of cultivation by the fixing of prices remunerative to farmers. Nominal wage rates rose by 14 per cent. between August 1939 and December 1940. Retail food prices, which rose by 25 per cent. in the same period, have been fixed more and more by the government, in some cases by means of subsidies designed to keep down the advance in the cost of living.

Germany has continued to apply a system of comprehensive price control by which the increase in wholesale prices and in the cost of living has been kept within narrow limits.

Price Movements in Germany.

Indexes on base of August 1939	Aug. 1939	Dec. 1939	Dec. 1940	March 1941
Wholesale prices . . .	100	100.5	103.5	104.3
Retail food prices . . .	100	98.3	101.4	102.5
Cost of living	100	99.3	102.7	103.8

The increase in prices has been mainly in finished industrial products (especially textiles, shoes, furniture and rubber articles), whereas agricultural prices showed practically no change. Strict rationing of the consumption of essential commodities and allocation of supplies of materials by official agencies are integral parts of the distributive system designed to ensure that shortages do not lead to increases in prices.

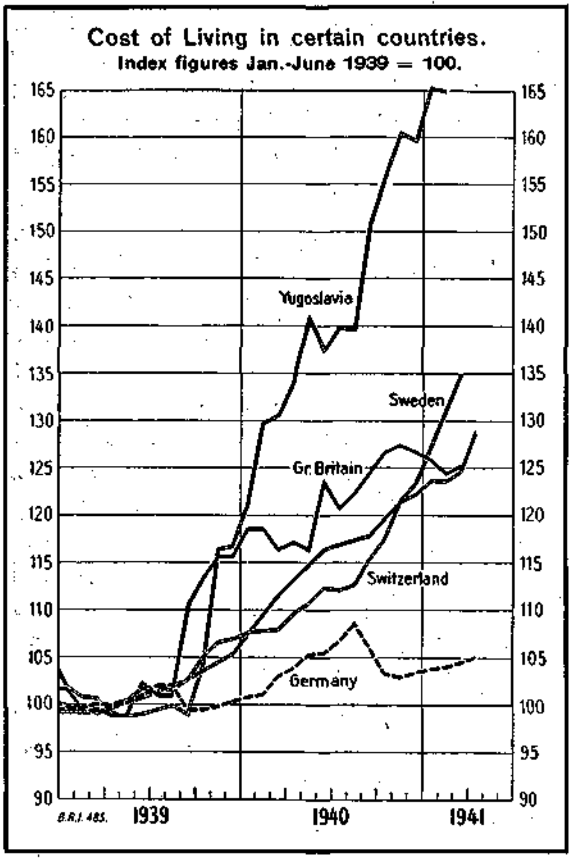
The price control in Germany, which since the beginning of the war has applied also to wages, was further extended in 1940. By decree of 6th November 1940 it was made compulsory to reduce prices in cases where, for instance, more efficient technical methods or a lowering in quality led to a rise in profits. In exceptional cases permission may be given to firms to surrender part of their profits instead of lowering prices. In addition to the "price stop" and "wage stop" already in force, a "profit stop" was thus introduced. Many difficult technical questions arise in this connection since, for instance, account has to be taken of the position of firms with production costs which deviate considerably from the normal, but the basic principle is that all elements which go to make up the price of finished articles shall be subject to control. In the spring of 1941 strict limitation of profits was further ensured by the imposition of heavy new taxation of all dividends exceeding the "normal" rate of 6 per cent. Permission is, however, given to adjust the capital structure in those cases where the share capital clearly falls short of the real position as regards the companies' own resources.

In Italy, by ministerial decree of 12th March 1941, the "price stop" instituted in June 1940 was prolonged for the duration of the war. Provision was made for prices to remain at the level prevailing on 30th June 1940 and for the prolongation of current contracts regarding remuneration for work, insurance, rents (with certain restrictions), lighting, etc. Although the official publication of price indexes has not been resumed, it is known that a rise in prices of certain commodities has taken place, especially as a result of the higher cost of imports. Moreover, the fact that certain necessary commodities were rationed or sold at moderate prices left a higher margin

Price Movements in Europe.

Indexes on base of August 1939 = 100	Wholesale Prices		Cost of living	
	Dec. 1940	March 1941	Dec. 1940	March 1941
Bulgaria	135	135	119	121
Denmark	172	178	136	139
Finland	.	.	124	132
Greece	.	.	123	.
Hungary	127	131	115	117
Norway	150	160	130	134
Portugal	145	.	111	114
Spain	130	.	134	.
Sweden	144	152	119	128
Switzerland	153	159	117	120
Turkey	.	.	120	124*
Yugoslavia	188	203*	149	155*

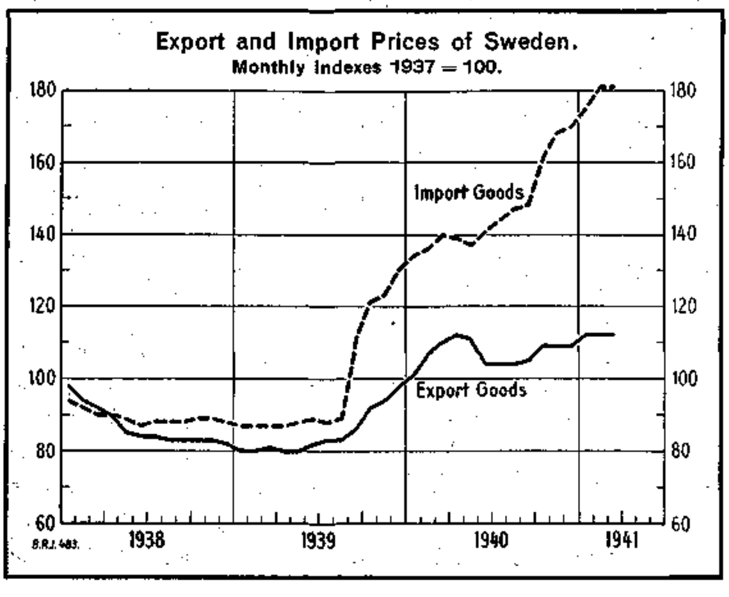
* February 1941.



of income in the hands of consumers, who directed their purchases to unrationed foods and to other goods which, on account of their variety, could not easily be submitted to the price control. In certain cases, especially where social considerations were involved, the state intervened to lower prices by way of subsidies paid to the producers, thus shifting a portion of the cost from the consumer to the taxpayer. Some increases in salaries, within moderate limits, were officially decreed, particular consideration being paid to the interest of mobilised men and their families.

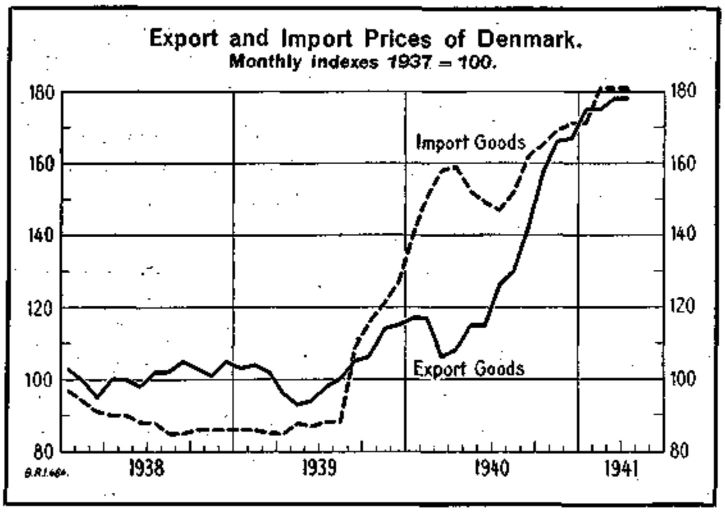
In other continental European countries for which price statistics are available, the rise in wholesale prices amounted to at least 30 per cent. from the outbreak of the war to March 1941.

The increase was highest in Yugoslavia, where it exceeded 100 per cent.; then came Denmark with more than 75 per cent., Norway and Switzerland with around 60 per cent., Sweden with more than 50 per cent., Bulgaria 35 per cent. and Hungary just over 30 per cent. The cost of living has risen less steeply – often by only one-half of the rise in wholesale prices.



Hindrances to trade, higher transport costs and soaring raw-material prices have as a rule produced considerable divergencies between prices for imported and for domestic goods and between raw-material prices and those for finished articles. In Sweden higher prices were fixed for farm products in order to compensate for the poor crop in 1940 and to stimulate agricultural production, but prices of imported goods have nevertheless risen more than three times as much as those of domestic goods. Since Swedish exports have been particularly affected by the cutting-off of trade with western countries the discrepancy between import and export prices has become unusually marked.

In Denmark, on the other hand, prices of export and import goods had risen about equally at the beginning of 1941. Danish exports of agricultural products prior to the spring of 1940 had been at world market prices, i. e. at a low level when calculated on a gold basis. The shift of exports to Germany, where prices of agricultural products were much higher at the prevailing rate of exchange, led to a rapid advance in the prices of Danish export goods.



In general, adjustment to the German price level has been an important factor in price movements on the Continent of Europe since the outbreak of war. In the years 1929-33 prices and wages in Germany were reduced by 35 and 20 per cent. respectively, i. e. to a greater extent than in other European countries, but the depreciation of the currencies of these other countries while the Reichsmark was maintained at par made the German price level, when calculated at official rates of exchange, higher than elsewhere. By the beginning of 1939 the resulting divergence of wholesale prices amounted to fully 30 per cent.; in relation to France it was even greater on account of the far-reaching depreciation of the French franc in 1938. In order to maintain equilibrium in her balance of payments notwithstanding the considerable price discrepancy, Germany imposed a comprehensive system of foreign trade control under which imports were restricted and subsidies granted to German exporters to enable them to compete on foreign markets.

The outbreak of the war and the virtual isolation of the Continent of Europe from the rest of the world strengthened Germany's trade position within the European area. Germany was able to abolish the export subsidies and to attract to herself goods which had previously been exported to the British Isles or extra-European countries. The result was that Germany's price level became one of the dominating influences in price developments on the continent. This has been the case especially in relation to the

Protectorate of Bohemia and Moravia and to Holland, consequent upon the abolition of exchange restrictions between them and Germany (and for the Protectorate customs duties as well); and the same forces have been at work also vis-à-vis other countries on the Continent of Europe. By the increases in prices and wages which have occurred since the outbreak of the war a considerable adjustment to the German level has no doubt already been effected, but in some cases discrepancies still remain, which, at the prevailing rates of exchange, are in no way negligible.

Apart from influences emanating from the foreign trade position, price movements in the various countries have been subject to a number of domestic influences, among which the increased cost of production of substitutes, poor crops in 1940 and higher prices paid to encourage an extension of farming, as well as the mounting budget deficits, have been the most important. Systems of price control are everywhere in force, and increased powers have been given to price controllers in 1940. Wage control is still an exception to the rule, but in no country can the government remain indifferent to important changes in wage rates. It is generally admitted that a rise in the cost of living should not be fully compensated by a rise in wages; when the higher living costs reflect an increased scarcity of consumption goods it is physically impossible to compensate everybody; and when indirect taxation is increased part of the purpose is often to restrict the volume of consumers' purchases, while full compensation would mean freedom from the particular tax increase. The compensation which has in fact been granted to wage-earners in different countries has been limited in general to about one-half of the rise in the cost of living, with special allowances in favour of larger families. Rationing makes it possible, as a rule, to ensure a more equitable distribution of available supplies than would be the result of competitive bidding in a free market and also to prevent shortages from resulting in exaggerated price rises. It has been the tendency everywhere to rely more upon direct intervention in the price system through rationing and control than upon credit restriction. In contrast to the war of 1914–18 a policy of cheap and plentiful credit is now being pursued, combined, however, with higher taxation and a series of measures (such as rationing of iron and steel) designed to prevent available funds from being used for unauthorised private investments. The extent to which the policy thus adopted will prove successful in withstanding excessive price increases will no doubt depend largely upon the determination with which it is carried out and, in particular, upon the strength shown by the authorities in resisting sectional interests. It is, however, no easy matter to make a system of price control fully effective; if the volume of credit and purchasing power in the hands of the public were allowed to increase without restraint, it is not certain that direct measures of price control could wholly neutralise the impulse to increased spending. The greater the "free sector" in a country the more imperative it becomes to consider all possible safeguards, including those of a monetary character, if inflationary tendencies are to be avoided.

III. PRODUCTION AND MOVEMENTS OF GOLD.

The outstanding facts in the gold situation are a continued increase in production and a further concentration of the world's monetary gold stock in the United States.

Even if, in the absence of official indications, the estimate for the gold output of the U. S. S. R. be reduced from 4.5 million ounces in 1939 to 4 million ounces in 1940, the gold production of the world attained a new record of 40.7 million ounces in 1940 — 4½ per cent. above the previous year. For the first time the figure of 40 million ounces has been exceeded, compared with less than 20 million ounces produced in 1929. Taking into account depreciation of currencies since 1931, the rise in value is, of course, steeper than the increase in physical output: in U.S. dollars of current value the production has increased by more than three times since 1929. In 1940 the world's gold production had a value of $1,425 million, of which the share of the British Empire came to about $850 million, just under 60 per cent. of the total.

The monetary gold stock of the United States rose by $4,351 million in 1940, i. e. by three times as much as the current gold production. At the end of 1940 the gold holdings of the United States Government amounted to $22,000 million, representing about 70 per cent. of the world's monetary gold stock of approximately $31,500 million (including the unreported holdings of exchange funds and other monetary institutions)*. The $9,500 million held by all other countries than the United States, although only 30 per cent. of the world's monetary gold stock, is still not far from the amount of gold held by the same countries in 1929, when they possessed a total of perhaps $11,000 million (at $35 per ounce). The gold holdings of the United States (also at $35 an ounce) rose from $6,800 million at the end of 1929 to $22,000 million at the end of 1940 by the absorption of the whole new production to the value of $11,700 million, the receipts from gold hoards in the East totalling some $1,700 million, certain amounts from circulation and hoards elsewhere, as well as approximately $1,500 million from monetary reserves in other countries.

1. THE SUPPLY OF GOLD.

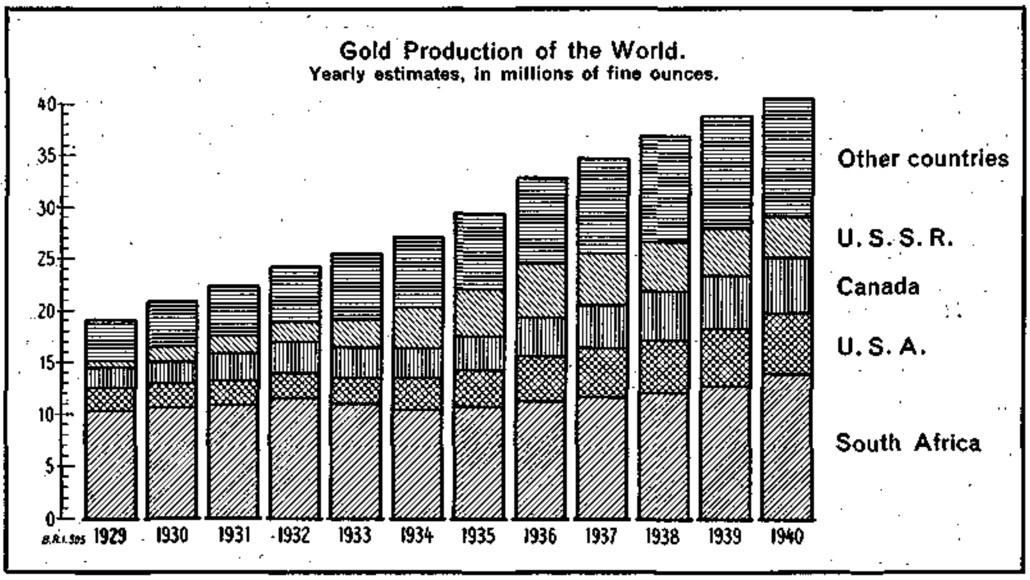
The continous increase in gold production can be seen from the table. The output of gold in South Africa rose by 9½ per cent. from 12.8 to 14.0 million ounces, accounting for two-thirds of the increase in the world's

* It is sometimes stated that the United States holds 60 per cent. of the world's monetary gold stock. But in this case attention is paid only to the reported reserves of central banks, which means that, for instance, gold held by exchange funds and the State Bank of the U. S. S. R. is not taken into account.

World Gold Production (Yearly estimates)	1929	1932	1938	1939	1940
	in thousands of fine ounces				
Union of South Africa	10,412	11,559	12,161	12,822	14,047
United States (1)	2,208	2,449	5,089	5,611	5,920
Canada	1,928	3,044	4,725	5,095	5,302
U. S. S. R. (2)	707	1,938	4,750	4,500	4,000
Australia	426	710	1,574	1,636	1,633
Korea	138	276	948	975	1,025 (2)
Mexico	652	584	924	944	950
Japan	335	402	760	850	925 (2)
British West Africa . .	208	293	730	830	924
Rhodesia	562	581	815	800	832
Colombia	48	248	521	570	632
Belgian Congo	173	243	473	510	517
Chile	26	38	294	325	341
British India	364	330	322	318	290
Peru	121	86	260	272	280
New Guinea	(3)	(3)	236	241	273
Sweden	(3)	132	234	230	210
New Zealand	120	166	152	172	204
Roumania	71	103	172	211	131
Other countries	693	1,072	1,898	2,071	2,264 (2)
Total World Production	19,192	24,254	37,038	38,983	40,700 (2)
	in millions of dollars (4)				
Value of Total World Production	672	849	1,296	1,364	1,425

(1) Includes Philippines. (2) Estimates. (3) Included in other countries.
(4) Dollars of present-day value equivalent to $ 35 per ounce of fine gold.

production in 1940. It proved possible to recruit more native labour, largely from the East Coast and from British territories in the tropical zone north of 22 degrees South. The number of natives employed increased by not less than 42,000 to a total of 347,000 at the end of 1940 (with a further increase of 25,000 in the first two months of 1941). Working costs rose by 7½ per cent. per fine ounce won, as a result of higher prices for materials, higher pay to those employed and the payment by the mining companies, during a part of the year, of the so-called gold realisation charges amounting to between 35 and 38 shillings per £100. From 1st January 1940 the price paid per ounce was, however, raised from a maximum of 150 to 168 shillings; as a combined result of this increase and of the higher output the value of South Africa's gold production rose from £96.0 million in 1939 to £118.0 million in 1940. The amounts which remained after deduction of working costs increased from £35.5 million to £44.2 million; since, however, taxation and miscellaneous items, such as allocations for stores and capital equipment, were considerably increased, the dividend disbursements were raised by only £1.2 million to a total of around £21 million. It should be added that the South African mines have continued the policy pursued in the last ten years of milling low-grade ore; the fact that they decreased the grade of ore crushed in 1940



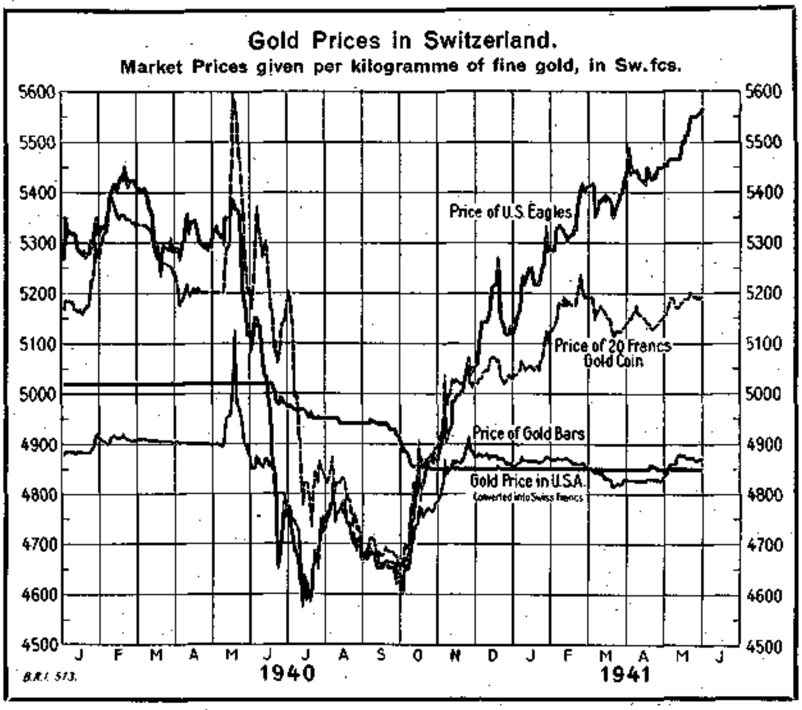
makes the high percentage advance in the output for the year even more remarkable.

The gold production of the United States increased by 5½ per cent. in 1940. It includes the production of the Philippine Islands, the latter being 18 per cent. of the total. In Canada gold production rose by 4 per cent. from 1939 to 1940, the industry employing about 40,000 persons, as compared with 25,000 in 1935. Australian production did not increase in 1940, but the high price for gold has improved the profit position of the gold mining companies. While in 1931 only four Australian gold mining companies paid dividends aggregating £65,000, not less than 54 companies were able to pay dividends in 1940, the total amount paid being £3.2 million. No information has been published with regard to the gold production of Korea and Japan in 1940, but it is known that further increases have occurred; the figures in the table must be regarded as approximations. For the U. S. S. R. even less information is available, the figures given in the table for the last two years being little more than guesses. In Europe (without the U. S. S. R.) total gold production amounted to 678,000 ounces in 1939 and was probably not much higher in 1940, representing only 1.7 per cent. of the world output of gold. The transfer from Roumania to Hungary of certain Transylvanian mines, as a result of the territorial changes in September 1940, has made it necessary for the authorities in Hungary to determine to what extent they will allow the gold mining companies now under their jurisdiction such premiums as were previously granted to them by the National Bank of Roumania.

The receipts of gold from hoards in Eastern countries had already ceased in 1939 so far as China and Hong Kong were concerned. Exports of gold from British India to the United States amounted to $50 million in 1940. This is the same figure as in the previous year and exceeds domestic gold production by about $40 million, the excess being presumably obtained from private holdings.

For the world as a whole the tendency to hoard gold seems to have passed through different stages during 1940. In the summer there appear to have been offers of gold from private hoards in several markets, prompted by a belief that its monetary use in future might be restricted or holdings confiscated and that gold would thus become less suitable as a refuge asset than it had been in the past. In the following autumn and winter, when these fears seem to have largely subsided, gold was again bought for private holdings. The movements on the gold market in Switzerland may be cited as an example to illustrate the different tendencies, although it should be underlined that the amounts traded in are small – in fact, insignificant in relation to the massive repatriation of private dollar funds into Swiss francs which set in during the summer of 1940.

It is interesting to note that from the autumn of 1940 the price of gold bars moved close to the gold price in the United States when converted into Swiss francs. Only for gold coins were higher prices paid, a sign of the limited character of the hoarding movement. The discrepancy in prices paid for Swiss gold coins and U. S. eagles seems to be due to other than Swiss demand for the relatively small supply of eagles available in the market.



Such information as is available with regard to the industrial consumption of gold points to an increase in recent years in the United States and little change on balance elsewhere. The figures in the table on the next page are taken from the Report of the Director of the Mint in the United States for the fiscal year ending 30th June 1940.

In the United States the industrial consumption of gold during the prosperity period in the 'twenties was around $60 million a year. With the depression

Industrial Consumption of Gold.

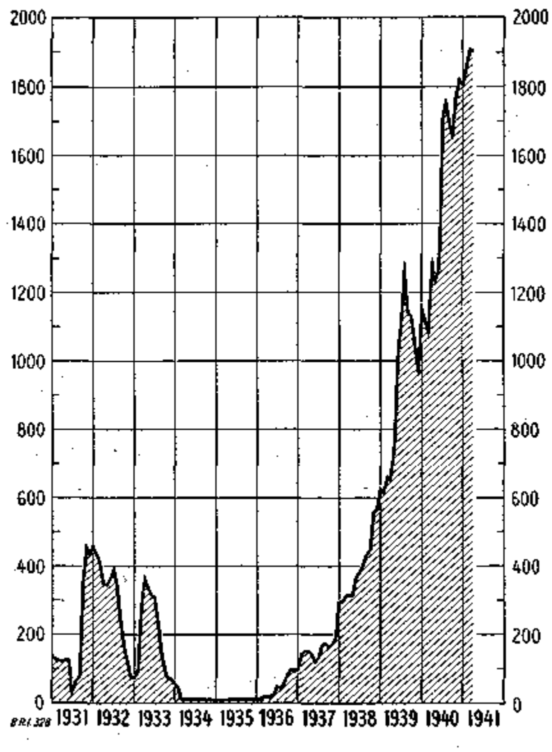
In millions of dollars	1938	1939
United States	30.2	38.8
Great Britain	11.4	10.5
Germany *	7.8	5.9
Switzerland	**	3.4
Roumania	1.4	1.4
Sweden	1.4	**
Canada	1.0	1.4
Hungary	0.9	1.3
Other countries . . .	3.9	1.5
Total	58.0	64.2

* Gold delivered by the Reichsbank. ** Not specified.

and the increase in the price of gold from $20.67 to $35 per fine ounce, consumption declined to a low of $14 million in 1934, from which it afterwards recovered to nearly $40 million in 1939. These are gross figures, taking no account of the return of old gold in the form of scrap, etc. Gold thus returned had a value of $76 million in 1934, but only $31 million in 1939. If the returns of old gold are deducted from the industrial consumption, the effect of this consumption on the supply of monetary gold is now so small in relation to the total that, for all practical purposes, it may be neglected.

2. MOVEMENTS OF GOLD.

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



The intensity of the physical movement of gold to the United States in 1940 is perhaps best shown by the fact that in the three months May, June and July gold to the value of $2,118 million was imported into the United States. For the year as a whole the gold imports amounted to $4,744 million, of which $645 million net were placed under earmark at the Federal Reserve Banks. The remainder was added to the monetary gold stock of the United States which, including acquisitions from domestic production and certain other sources, rose by $4,351 million in 1940.

What were the principal factors behind this huge movement? The estimate of the United States balance of payments for 1940 shows a surplus of $1,319 million on the current account (which includes, besides the export surplus, such items as dividend payments, tourist traffic, freights, etc.). The settlement of this surplus balance accounts for 30 per cent. of the gold acquisitions. As to the remaining 70 per cent., representing just over $3,000 million, the underlying movement was no longer a flow of funds on private account to the United States but mainly transfer of funds to build up official balances in New York for the account of foreign central banks and governments.

Of the net gold imports to the United States in 1940 $3,255 million out of a total of $4,744 million came from Canada and the United Kingdom. Net imports from France were $242 million — practically all during June 1940. South Africa shipped $185 million direct to the United States. The value of South Africa's gold output in 1940 was $492 million, of which $118 million went to increase the holdings of the South African Reserve Bank. Outside the United States this was the largest addition to the monetary reserves of any country. During 1940 the gold reserves of Holland, Sweden and Switzerland fell by $270 million, almost wholly in the first half of the year and principally on account of payments for excess imports of goods from the United States.

After the military and political events in the spring of 1940 certain central banks ceased to publish the magnitude of their gold reserves. A number of banks have reported exactly the same gold holdings at the end of 1940 as at the end of 1939 (as may be seen from the table on the next page). In several cases gold continued to be held outside the reported reserves, and changes in these undisclosed holdings have no doubt occurred in the course of the year.

While the total of the reported gold holdings had a value of $29 milliard at the end of 1940, the total monetary gold stock at that date may be estimated (as already indicated above) at probably $31.5 milliard. The weight of this stock is about 28,000 metric tons. Considering that this represents the accumulated product of hundreds of years, gold must still be considered a very scarce metal; but it should be added that more than half of the total stock has been produced since 1920.

In the ardent discussions to which the problems connected with gold have given rise since the war began, two questions have in particular been raised: Firstly, what are the effects of the concentration of so much gold on the price structure and the credit system in the United States? Secondly, how is the status of gold affected by the development of clearings in Europe?

As to the first question, the principal tendencies may briefly be stated as follows: gold sent to the United States before the outbreak of the war largely reflected movements of capital funds, which had hardly any effect on the immediate demand for goods and services, the funds produced by the sale of gold remaining, for the most part, as idle deposits in the banking system or otherwise adding to the already redundant supplies of unused credit in the country. Recent gold shipments, on the other hand, have been

Reported Gold Reserves	End of 1938 (1)	End of 1939 (1)	Loss (—) or gain (+) during 1939	End of 1940 (1)	Loss (—) or gain (+) during 1940
	in millions of dollars (at $35 per fine ounce)				
Group 1: U. S. A. (2)	14,512	17,644	+ 3,132	21,995	+ 4,351
South Africa	220	249	+ 29	367	+ 118
Turkey	29	29	0	88	+ 59
Java	80	90	+ 10	140	+ 50
Portugal	69	69	0	93	+ 24
Yugoslavia	57	59	+ 2	82	+ 23
Belgium (3)	728	714	— 14	734	+ 20
Uruguay	69	68	— 1	88 (4)	+ 20
Mexico	29	32	+ 3	47	+ 15
Brazil	32	40	+ 8	51	+ 11
Roumania	133	152	+ 19	158	+ 6
Total	15,958	19,146	+ 3,188	23,843	+ 4,697
Group 2: British India	274	274	0	274	0
Bulgaria	24	24	0	24	0
Chile	30	30	0	30	0
Greece	27	28	+ 1	28	0
Hungary	37	24	— 13	24	0
Japan	164	164	0	164	0
New Zealand	23	23	0	23	0
Peru	20	20	0	20	0
United Kingdom (5)	2,690	1	— 2,689	1	0
Total	3,289	588	— 2,701	588	0
Group 3: Denmark	53	53	0	52	— 1
Egypt	55	55	0	52	— 3
Germany	45	43	— 2	40	— 3
Colombia	24	21	— 3	17	— 4
Italy	193	144	— 49	137 (6)	— 7
Finland	25	27	+ 2	12	— 15
Switzerland	701	549	— 152	502	— 47
Holland	998	692	— 306	617	— 75
Argentina	431	466	+ 35	353 (7)	— 113
Sweden	321	308	— 13	160	— 148
Canada	192	214	+ 22	7 (8)	— 207
France (9)	2,435	2,714	+ 279	2,222	— 492
Total	5,473	5,286	— 187	4,171	— 1,115
Grand Total (10)	25,200	25,500	+ 300	29,000	+ 3,500

(1) Partly estimated.

(2) Not including gold held in Stabilization Fund; $ 80 million in December 1938, $ 156 million in December 1939 and $ 48 million in December 1940.

(3) Not including gold held by the Treasury; $ 81 million in December 1937, $ 44 million in December 1938 and $ 17 million in December 1939 and December 1940.

(4) Including certain reserves previously not reported.

(5) Not including Exchange Equalisation Account: September 1937, $ 1,395 million and September 1938, $ 759 million. In September 1939, $ 1,162 million was transferred from the Bank of England to the Account.

(6) Last data reported.

(7) Since 1940 figures of certain gold reserves no longer available.

(8) In May 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.

(9) Not including gold held in Exchange Stabilisation Fund, i. e. $ 331 million in December 1938 and $ 477 million in May 1939 (latest data reported).

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

made essentially for the purpose of acquiring dollars to be used in payment (even prepayment) of deliveries and for investments in plant and equipment, and they may therefore be expected to expand the volume of active demand for goods and services in the American market. It will not, however, be easy in practice to trace the effects of this expansion, since at the same time the United States has increased her own budget expenditure in such large proportions that the foreign orders, financed by gold shipments, represent a minor item compared with the huge advance in domestic spending. As regards the credit system, incoming gold leads, of course, to an increase in excess reserves, since the new demand deposits created need be covered by reserves only to the extent of 12–22¾ per cent. But deposits with member banks have been rising steeply of late for reasons other than gold imports (as a result of increased commercial lending and continued purchases of government securities by the banks) and the amount of money in circulation has also gone up; both movements tend to reduce total member-bank excess reserves. Indeed, with the slowing-up of the gold inflow since the autumn of 1940, these reserves have fallen from a maximum of $7,000 million at the end of October to $5,400 million in June 1941. The importance of taking action against the effects of further gold acquisitions seems somewhat less pressing when excess reserves are on the decline.

Already in a speech on 3rd May 1940 the Secretary to the United States Treasury Department dealt with a number of suggestions put forward in the gold discussions. He declared himself opposed to a cessation of gold purchases, a cut in the price of gold and a discrimination against certain countries in the purchase of gold. His conclusion was that continued acceptance of gold by the United States was "the only sound course of action open to us".

The development of clearings in Europe has given rise to certain fears with regard to the future position of gold as an element in the monetary structure. It has been noted that Germany has been able to finance rearmament and war with very slight gold reserves and that the foreign trade of Germany and Italy has been carried on largely on a clearing basis. Hence the question is being asked whether a new monetary system is being developed which will altogether dispense with the services of gold.

In authoritative statements made on this subject in Germany and Italy a distinction is drawn between different functions of gold. The President of the German Reichsbank said in a speech on 26th July 1940 that "in any case gold will in the future play no rôle as a basis of European currencies, for a currency is not dependent upon its cover but on the value which is given to it by the state, i. e. by the economic order as regulated by the state". "It is", he added, "another matter whether gold should be regarded as a suitable medium for the settlement of debit balances between countries; but we shall never pursue a monetary policy which makes us in any way dependent upon gold, for it is impossible to tie oneself to a medium the value of which one cannot determine oneself."

The Governor of the Banca d'Italia, in a speech on 29th March 1941, also pointed out that, although the possibility of a development of this kind could not be excluded in connection with European trade with overseas countries, it was difficult to believe that this would occur immediately after the cessation of hostilities, when payment in gold to correct disequilibria would in all probability be necessary; the need of maintaining metallic reserves would, however, be concentrated more and more on the clearing centres. "For years now the importance of gold as backing for the currency and as basis of the credit structure has been non-existent, the automatic working of the system having failed to stand the test just when exceptional circumstances called for its efficient functioning: under state control credit has been commensurate with production and labour, and the stability of the currency has been maintained independently of the amount of the gold reserves."

The tendency in these and similar statements is to circumscribe strictly the rôle which gold may play in the monetary system: instead of exerting a dominating influence on credit policy, its usefulness is found more particularly in its services as an international medium for settling balances arising from time to time between different countries, and thus preventing them from disturbing the exchange markets. In that way a greater flexibility is attained than would be possible if complete balancing, even over brief periods, were exacted. Besides gold, the U. S. dollar and some other currencies have often been used as a settling medium; but the licensing system to which dollar assets in the United States have been subjected has made it difficult, if not impossible, for many countries to make use of the dollar for such a purpose. The result has been a certain tendency, of late, to fall back more upon gold for payment of outstanding balances; central banks have been buying gold from each other at more or less fixed prices applicable specifically to the transactions between them. Sometimes clearing agreements have contained provisions as to the magnitude of balances which may be settled otherwise than by export of commodities.

As long as war conditions last, the likelihood is that in domestic credit policies little attention will be paid to changes in the reserves of gold and other foreign assets, on account of the dominating importance of other considerations. On the other hand, a shift in gold movements (and the same applies with certain reservations to movements in foreign exchange holdings or clearing balances) can probably not be altogether neglected. When gold is bought or sold by a central bank, the credit structure is subjected to certain direct effects which, as a rule, can be neutralised only by specific measures. Moreover, in normal times gold movements may well be a sign of a maladjustment which requires correction. If, instead of physical transfers of gold, changes occur in the movements of other foreign assets, including clearing balances in the hands of central banks, the problem is not altered fundamentally, except that these assets may not be so easily transferred to third parties. If it is taken for granted that a monetary system does not function satisfactorily unless equilibrium is maintained in the economic and financial relationships between the different countries belonging to that system, then it is not unlikely that net changes in the balance of payments between countries (and consequently in their monetary reserves) will serve as one among several indications of disequilibrium and will give rise to corrective measures in the field of credit policy or direct intervention in foreign trade, or both. This does not mean a simple application of automatic rules but implies that, for a fundamental equilibrium to be maintained, regard must normally be paid to the repercussions of the balances of payments on monetary reserves.

IV. INTERNATIONAL CAPITAL MOVEMENTS.

European investments in the United States at the outbreak of war in 1914 have been estimated at over $6,000 million, of which British interests in American railroads formed the most important part. During the war of 1914–18 these foreign dollar holdings were heavily drawn upon and by the end of 1919 the total foreign stake in the United States was probably not more than $2,800 million. The considerable capital outflow from the United States in these years (indicated by the decline of foreign investments in the country as well as by the mounting "war debts") was continued in the form of private capital issues after the war, and in the 'twenties the United States was the world's principal exporter of capital. By 1929–30 total American investments abroad probably reached $15,000 million, offset to some extent by foreign investments in the United States. In addition, "war debts" to a nominal amount of over $ 10,000 million were outstanding and the service was being paid.

This movement was sharply reversed upon the collapse of the New York stock exchange, the international monetary crisis and the Hoover moratorium, and during the 'thirties the United States became the world's principal importer of capital, not only through the withdrawal of dollar credits previously granted to foreign markets, but, especially since 1934, by the influx of foreign funds. By the end of 1939 American investments in foreign countries had been reduced to $ 11,400 million, while foreign investments in the United States had grown to $9,500 million, so that — apart from war debts — the net creditor position of that country had fallen below $2,000 million. The reduction of the net creditor position had for some time averaged more than $1,000 million a year and it was expected that by 1940 or 1941 the United States might again become a debtor country on foreign account (although the principal owner of the world's gold stock). As a result of the war in Europe, this expectation was not realised — the movement of funds to the United States changed in character when dollar resources were used for the purchase of war materials. The growing surplus in the merchandise balance and the granting of credits by the Export-Import Bank has, in fact, strengthened the United States' creditor position during the past year.

An analysis of the capital movement towards the United States is given in the following graph and table.

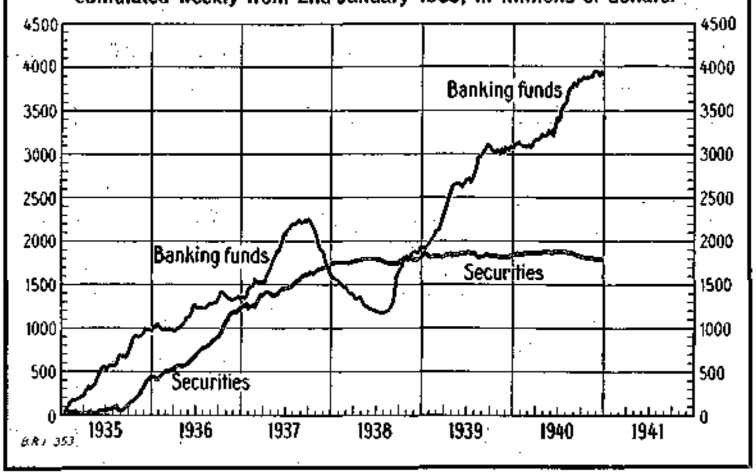
Reported Movement of Capital towards United States.

Yearly in millions of dollars	Banking funds			Security transactions			Total reported capital influx	"Residual" in balance of payments
	official funds (1)	other funds	total	U. S. securities	foreign securities	total (2)		
1935	10	955	965	317	125	448	1,413	350
1936	71	326	397	601	191	799	1,196	170
1937	163	93	256	245	267	546	802	600
1938	10	321	331	57	27	84	415	530
1939	288	844	1,132	*85**	116	64	1,196	1,040
1940	658	188	846	*141**	78	*42**	804	1,430

* Sale of securities or efflux of capital.
(1) Central-bank funds in New York, including funds transferred from central-bank to government accounts.
(2) Including movements of brokerage balances.
Note: It must be emphasised that, although of considerable interest, the reported movements of capital are necessarily incomplete. The "residual", which represents the volume of unidentified items (predominantly capital movements of various kinds) in the balance of payments, as shown in the last column of the table, has grown to very high figures in recent years and gives some measure of the unreported transactions.

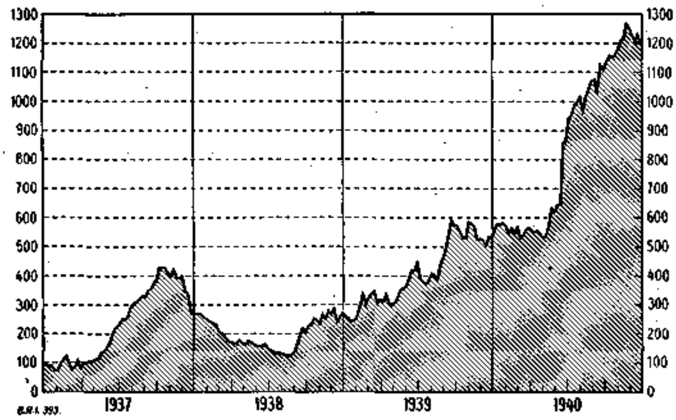
The movement of foreign capital into U. S. domestic securities almost ceased with the slump on the stock exchange in 1937, while repatriations of foreign securities were also suspended in that year, when commodity prices fell and the balances of payments of foreign debtors (especially South American countries) abruptly became passive. In 1938 the net influx of foreign capital was comparatively small but in 1939 capital flight from Europe was on a large scale and 95 per cent. of the reported influx into the United States was into dollar balances, three-quarters of which were on private account.

Net Movement of Capital to United States
cumulated weekly from 2nd January 1935, in millions of dollars.



In 1940 the liquidation of U. S. securities, which had begun in 1939, was continued with the result that dollar balances increased more than the reported net influx of all foreign capital. As exchange control now applies to most of the countries from which the capital movement originated before the war, about 80 per cent. of the net reported influx was in official balances (on account of central banks and governments) and took place in the second half of the year. Part of this increase of official dollar balances was due to the shipment of gold, part to the sales of private balances to the home central bank, induced

Foreign Central Bank Balances in U. S. A.
in millions of dollars.



The data, which include both deposits and short-term assets, are estimated on the basis of published changes in these funds since the end of 1934 and an estimated amount of balances held with the Federal Reserve Banks at the end of 1934. Changes in central bank funds with other New York banks and bankers since June 1938 are included from that date, but no allowance has been made for the amount of these funds as on 30th June, 1938.

by fears of "freezing", and part to mobilisations of U.S. securities and their sale on foreign government account.

In the rise of foreign banking funds in 1940 the United Kingdom had no part, the chief increases being, in Europe, for account of France ($202 million) and Switzerland ($139 million) and, elsewhere, for Canada ($182 million), Latin America ($123 million) and Asia ($125 million). A considerable proportion of the European dollar balances and other assets in the United States were made subject to license. On 10th April 1940 an executive order was issued by the President of the United States regulating by licence all transactions in foreign exchange, transfers of credit, etc., of Denmark and Norway and their nationals. The practical effect of this was to immobilise all the property of these countries in the United States and to prevent the utilisation or transfer of their assets. Subsequent executive orders up to the end of 1940 extended the freezing to Belgium, Holland, Luxemburg, France, Latvia, Estonia, Lithuania and Roumania. The amounts involved are shown in the following table.

Foreign holdings of United States property affected by control.

Type of asset — in millions of dollars	Denmark	Norway	Holland	Belgium	Luxemburg	France	Latvia, Lithuania, Estonia	Roumania	Total
Bullion, currency, time and demand deposits	55	100	700	442	30	988	26	46	2,387
Securities, foreign and domestic	27	54	796	251	16	448	2	2	1,596
Credit instruments and claims	2	10	94	52	1	59	1	2	221
Goods, merchandise and chattels	4	6	9	6	1	17	0	2	45
Real property	1	2	14	1	0	10	0	1	29
All other property interests	3	5	9	9	0	72	0	0	98
Total	92	177	1,622	761	48	1,594	29	53	4,376

Note: Summary excludes reports by insurance companies and certain minor contra items.

The amount immobilised at the end of 1940 was thus nearly $4,400 million, roughly one-half of the total foreign assets in the United States. Certain releases of funds were allowed under licence, the most important being some $14 million to permit the Roumanian Government to purchase the properties of the International Telephone and Telegraph Company in Roumania. In 1941 further foreign funds were made subject to license by presidential executive order.

Free capital movements towards countries other than the United States were on a relatively smaller scale and were doubtless due in a large measure to fears of having dollar assets frozen in the United States. Canada and certain South American countries, particularly the Argentine and Brazil, appear to have been the chief overseas recipients of these refugee funds, which made their exodus not only by way of capital transfers on the markets but also by the physical removal of securities, jewellery and other valuables. These movements are difficult to measure statistically but were not unimportant from the point of view of the receiving countries. In Europe there were notable movements of private capital to Switzerland and Sweden from the U. S. A. in the second half of 1940, dollars being sold on private account and dollars (or gold) purchased by the central banks, which, if the exchanges were to remain stable, were themselves forced to assume the risk of having their dollar assets immobilised. On balance there was no change in the amount held in the United States but a transfer in the ownership of the funds. Some details of these movements are given in the chapter on Exchange Rates. In the Far East there was a certain movement of capital from Hong Kong to the free market in Shanghai.

As regards sales of U. S. securities by foreign holders, interest naturally centres on the dollar position of the United Kingdom. Net sales of U.S. stocks and bonds from the United Kingdom as reported in America amounted to only $67 million during 1940 although the volume of securities actually liquidated was, according to British sources, considerably greater, amounting to $334 million in the first sixteen months of war, a large part of the sales being directly negotiated through non-reporting channels. About a week before the outbreak of war British residents were obliged to register at the Bank of England all securities payable in ten specified foreign currencies, including U. S. and Canadian dollars. During 1940 three requisition orders were issued applying to U. S. securities, including 164 common stock issues with most of the market leaders, and further requisitions were made in January and April 1941. (Requisitions of dollar assets have also been made in other parts of the British Empire but these are of lesser importance.) Of the $950 million registered in the United Kingdom, rather less than one-third had been sold by the end of 1940, as the table on the next page shows.

Of the total gold and dollar resources of the United Kingdom, amounting to nearly $4,500 million on the outbreak of war, rather more than one-half had been utilised by the end of 1940, the liquidation falling most heavily upon the most easily available asset, gold, while direct business investments had not been touched (although negotiations to realise such assets or to obtain loans against them, particularly from the Reconstruction Finance Corporation, had been initiated). In addition to the $2,316 million actually utilised as shown

United Kingdom Gold and Dollar Resources.

In millions of dollars	Amount held		Utilised in sixteen months
	31st August 1939	31st December 1940	
Gold	2,038	292	1,746
Dollar balances	595	359	236
Market securities	950	616	334
Direct and miscellaneous investments	900	900	—
Totals	4,483	2,167	2,316

Notes: Official British estimates presented by U. S. Secretary of Treasury to the Chairman of the Foreign Affairs Committee of the House of Representatives on 21st January 1941 (as reproduced in the Federal Reserve Bulletin). Estimates on market valuation.

Of the gold and dollar assets remaining at the end of 1940, $356 million were considered unavailable, $51 million being in gold (of which $30 million were scattered in different parts of the world and $21 million held against forward exchange contracts) and $305 million private dollar balances, the minimum necessary for the transaction of current business.

above, a further $965 million gold mined or dishoarded during the sixteen-month period was sold abroad to cover the total requirements of the sterling area, amounting to $3,281 million.

It is necessary to include the whole sterling area in these figures, since the United Kingdom makes available to other countries of the area the dollars they currently require, while it is customary for most of the gold produced or dishoarded and the dollar exchange acquired to be made available to the United Kingdom. A summary of the transactions during the first sixteen months of war is given below.

Gold and Dollar Transactions of Sterling Area.
September 1939–December 1940.

	In millions of dollars
Goods and services	
Purchased from the United States	2,045
Sold to the United States	1,015
Excess of purchases over sales	1,030
Net gold and dollar payments to countries other than the U. S. (some for capital purposes)	725
Capital outflow	
Capital assistance and advance payments to the U. S.	720
Capital withdrawals, mainly from the United Kingdom	735
Miscellaneous items and errors of estimation	71
Net payments met in gold and dollars	3,281

Notes: Summary of official data as in previous table. The sterling area represents the British Empire, excluding Canada, Newfoundland and Hong Kong, but with the addition of British mandated territories and of Egypt, Irak and the Anglo-Egyptian Sudan.

Of the $3,281 million, $725 million was paid in gold or dollars for an excess of merchandise purchases from countries outside the sterling area and the United States (including $225 million to Canada). The balance of over

$2,500 million was paid almost wholly to the United States. Purchases from the United States were twice as great as sales and an excess of over $1,000 million had to be paid in cash. Further, the repayment of earlier export credits, required by the cash-and-carry provision of the Neutrality Act, took $200 million; payments for American supplies in advance of deliveries required $570 million and $150 million net was paid out in capital assistance to U. S. firms working on British orders. The remaining sale of $535 million was due to exchange operations, $300 million being withdrawn by Americans and others through the sale of free sterling to American importers and $235 million absorbed by the liquidation of the forward position in dollars.

War expenditure of the United Kingdom covered by external resources was given in a White Paper published in April 1941.

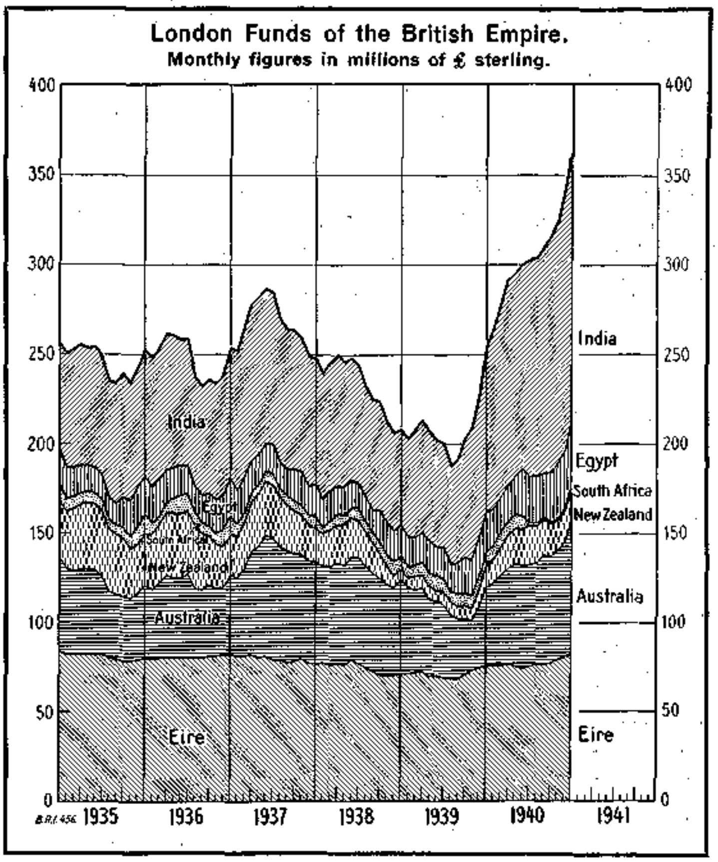
United Kingdom War Expenditure covered by external resources.

Form of external resources	Year to end August 1940	Half-year to end February 1941	Total period of eighteen months	Total period: in dollars
	in millions of £ sterling			
Proceeds of pre-war resources of the Exchange Equalisation Account	184	204	388	1,552
Other overseas sources	358	275	633	2,532
Totals	542	479	1,021	4,084

No direct comparison of these figures with those previously given for the utilisation of gold and dollar assets can be made, with the information available. The periods covered are not the same; one set of figures applies to the external position of the sterling area as a whole, while the other deals only with the United Kingdom and with war expenditure.

In particular, the above table includes the special Canadian assistance given to the United Kingdom (excluded from the previous table) as well as the accumulation of sterling resources held in London by the other Dominions and territories of the British Empire. British Government purchases from the Empire or other parts of the sterling area in a sense provide their own financing when the proceeds of the sales are kept as sterling balances or invested in sterling securities. The accumulation of London funds by the British Empire, shown in the following graph, is thus of first-rate importance in the financing of the war.

The downward trend of Empire funds in London due to the passive balance of payments of the Empire was sharply reversed in August 1939, and in the sixteen months to the end of 1940 there was a continuous gain which, for the countries shown in the graph, amounted to £170 million. The very steep rise of over £100 million up to March 1940 covers the main exporting season of these countries and the first prepayment of exports purchased



on British Government account. This prepayment was a non-recurring factor and the growth of London funds in the last four months of 1940 was £15 million less than in the corresponding period of 1939. The apparently more rapid rise in the earlier period is also explained by the fact that Empire funds in London tend to accumulate in sterling balances and Treasury bills in the first place, and are only later utilised for the purchase and repatriation of securities (when they generally disappear from the graph).

By far the greatest increase is shown for Indian funds — some £90 million from August 1939 to the end of 1940. In addition, Indian securities were repatriated both by purchase on the market and through a conversion scheme announced in February 1940, enabling the transfer of Indian stocks from denomination in sterling to rupees. The repayment of outstanding sterling securities was made difficult by the fact that the redeemable stocks could not be called before 1942 at the earliest. In order to overcome this difficulty the British Treasury in February 1941 requisitioned all dated Indian stocks (with earliest redemption dates ranging from 1942 to 1958), totalling some £90 million and bearing interest at rates ranging from 3 to 5 per cent. In the middle of May 1941 it was stated that of the Indian sterling stocks requisitioned £70 million had been purchased.

The movements of the other sterling funds shown in the graph are of much less importance. In the case of Eire, the increase of the net sterling holding of the banks appears to be due, in part at least, to special reasons: the realisation of sterling securities by the Irish public and the transfer of funds by British life assurance companies to the recently-formed Irish company. The increase in Australian and New Zealand funds must be read in the light of the arrangement with the United Kingdom for temporary loans to cover overseas war expenditure (made at the rate at which funds could be raised by the British Treasury). The decrease in the sterling funds of the Reserve Bank of South Africa to a very small balance was due to the repayment of £7.9 million 5 per cent. South African stock on 1st July 1940. Surplus sterling resources of the South African commercial banks appear to have remained with little change around £5 million.

Outside the graph the most important external assistance from the Empire was the financing of British purchases by the Canadian Government. It was officially stated in Canada that in the first 17½ months of the war (i.e. to the middle of February 1941) the deficit in the British accounts with that country amounted to $737 million (Canadian dollars), say £166 million, of which £56 million was settled in gold and £75 million by the repatriation of Canadian sterling securities (partly requisitioned by the British Treasury for this purpose in 1940) while Canadian sterling balances grew by £35 million. British Government purchases in the Crown Colonies have been an important factor making for increased sterling resources of the various Currency Boards, but up-to-date estimates of the amounts involved are not easy to establish.

Other countries, outside the British Empire, hold sterling balances, the movement of which appears to have shown a net decline. French sterling funds remaining in June 1940 were blocked and could thus be drawn upon only for specifically permitted purposes. Other funds blocked in London, as, for example, Norwegian, Dutch and Belgian, have in some cases been fed from proceeds of certain "invisible" items of the balance of payments of these countries (receipts from shipping, etc.) and drawn upon for some expenses, including service of the external debt, but the total movement was not important compared with that of Empire countries. The increase of the sterling reserve of the Bank of Greece from £6.9 million in December 1939 to £18.8 million in December 1940 was largely the result of sterling credits granted during the latter part of the year. Argentine funds are said to have increased to £2½ million at the end of 1940, but of more importance was the granting of a credit by the Argentine Government for the purchase of wheat, etc. Iceland accumulated funds in London during the year and in November 1940 redeemed the £500,000 outstanding on the 5½ per cent. sterling loan of 1930. On the other hand, Swiss sterling assets were drawn down on the year, to judge by the persistent discount on free sterling in the Swiss market.

Germany also has been able to draw on external resources to finance the war effort: thus German debts accumulated on European clearings in the second half of 1940 and payments of occupation costs helped to support the German army outside the territory of the Reich. In the last months of 1939 and in early 1940 excess of German exports towards Holland, Italy, Switzerland, Yugoslavia and other contiguous countries had resulted in a considerable repayment of Germany's clearing debts to these countries. Later, especially after the campaign in the spring and summer of 1940, Germany's imports from Denmark, Belgium, Holland, France, Slovakia, Switzerland and certain other countries exceeded the current exports to these countries and clearing

"Spitzen" of considerable size were created. The amounts due to individual exporters were generally paid by the domestic central banks and this development was, therefore, of particular monetary importance for the countries concerned. It should, however, be added that Germany built up clearing claims against other countries, e. g. Hungary, Italy, Sweden and Yugoslavia. Owing to the fragmentary nature of published material, it is not easy to form an estimate of the volume of Germany's net clearing debts incurred during 1940, but from the available data a figure of around RM 1,000 million would not appear inappropriate. Occupation costs paid for the upkeep of the German army in occupied territories are of greater importance, but here again complete data as to the amounts paid and actually utilised have not been published. From 25th June 1940 to the end of the year the equivalent (at Fr. fcs 20 per Reichsmark) of RM 3,857 million had been credited to German account at the Bank of France, of which RM 1,787 million had been effectively utilised. Occupation costs in other countries doubtless raised the total utilised above RM 2,000 million. For the financial year 1941–42 taxation and other internal revenue in Germany has been estimated to produce RM 36.4 milliard, while the addition of the "Matrikular" contribution of the Protectorate and occupation costs raised the total "above RM 40 milliard", according to the Secretary of State in the German Ministry of Finance, so that at least ten per cent. of Germany's total budget revenue (apart from borrowing) may be covered by external resources.

Although foreign trade in wartime is diverted from its normal channels and follows lines dictated more by political than by other motives, and although the individual exporter usually receives payment in cash, yet between countries as a whole some way must be found to finance inequalities in the incidence of export receipts and import payments. The British Government pays cash or in advance for supplies from the Empire and the accumulation of officially-held sterling resources of the Empire in London directly (through the purchase of Treasury bills) or indirectly (by the holding of balances or by other forms of sterling investment) finances the British Treasury: similarly the German importer may pay cash to the clearing office, but the European exporter is financed by his domestic banking system, which, as a counterpart, holds Reichsmark clearing claims. These are not credits for fixed amounts granted to cover specific transactions but general credits arising in the course of business. In so far as foreign credits have been expressly granted in Europe, they have generally had some underlying military or political motive: British credits to Greece and Turkey come in the former category and Swedish credits to Finland in the latter.

Outside Europe, the activities of the United States Export-Import Bank are becoming of greater significance for the South American countries cut off from their European markets, especially since a Congressional authorisation was made to raise the capital of the Bank by $500 million, to be devoted to such loans. Although China was the chief beneficiary as regards actual loans in 1940 and Latin America accounted for only 20 per cent. of the total loans outstanding at the end of March 1941, commitments to make additional loans to Latin America represented 70 per cent. of all such commitments. Of the twenty Latin American republics, all but four (Bolivia, El Salvador, Guatemala and Honduras) have at some time received Export-Import Bank credits. Loan commitments to Latin America during 1940 amounted to $168 million: 70 per cent. were designed to liquidate exchange arrears and to make dollars available for current imports, in order to cushion the impact of the closing of European markets and make some relaxation of exchange controls practicable. On these loans the interest rate is normally 3.6 per cent. Of particular significance as a stimulus to the industrialisation of South America was the loan commitment of $20 million at 4 per cent. to aid the Brazilian Government in the construction of a steel-mill.

Export-Import Bank Loans Outstanding.

In millions of dollars	Loans outstanding at end of			Commitments to make additional loans 31st March 1941
	1939	1940	March 1941	
To Latin America:				
Argentina	—	0.1	0.1	62.4
Brazil	16.4	13.6	13.5	51.4
Chile	0.5	2.9	3.9	14.6
Colombia	0.0	5.8	7.7	2.1
Costa Rica	—	0.0	0.1	5.5
Cuba	—	—	—	15.3
Dominican Republic	—	—	0.0	3.3
Ecuador	—	0.0	0.0	1.2
Haiti	1.9	3.4	3.9	1.6
Mexico	0.1	0.1	0.1	—
Nicaragua	0.1	1.1	1.6	2.9
Panama	—	1.0	1.1	3.3
Paraguay	0.1	1.2	1.5	2.4
Peru	—	—	—	10.0
Uruguay	—	—	—	7.5
Venezuela	—	0.1	0.2	3.4
Sub-total	19.1	29.4	33.8	186.9
To Rest of World:				
China	25.0	54.7	80.8	40.5
Denmark	—	—	—	10.0
Finland	—	18.2	23.0	12.0
Hungary	—	—	—	1.0
Iceland	—	0.6	0.6	0.4
Iran	0.1	—	—	—
Italy	3.2	—	—	—
Norway	—	0.2	0.2	9.8
Poland	3.3	3.3	3.3	—
Portugal	0.2	0.9	0.7	0.3
Spain	4.3	12.5	11.2	—
Sub-total	36.2	90.3	119.8	74.0
To U. S. Exporters, country unspecified	9.9	11.3	12.5	5.1
Total	65.2	131.0	166.2	266.0

Of the European loans, the $20 million granted to Finland in 1940 was heavily drawn upon, but the Danish loan was unused and only a very small part of the Norwegian loan was spent. $15 million was advanced to Sweden but the $4 million employed was repaid and the balance not utilised. The immobilisation of European assets in the United States has now made certain credit commitments purely nominal or they have been cancelled in the meantime.

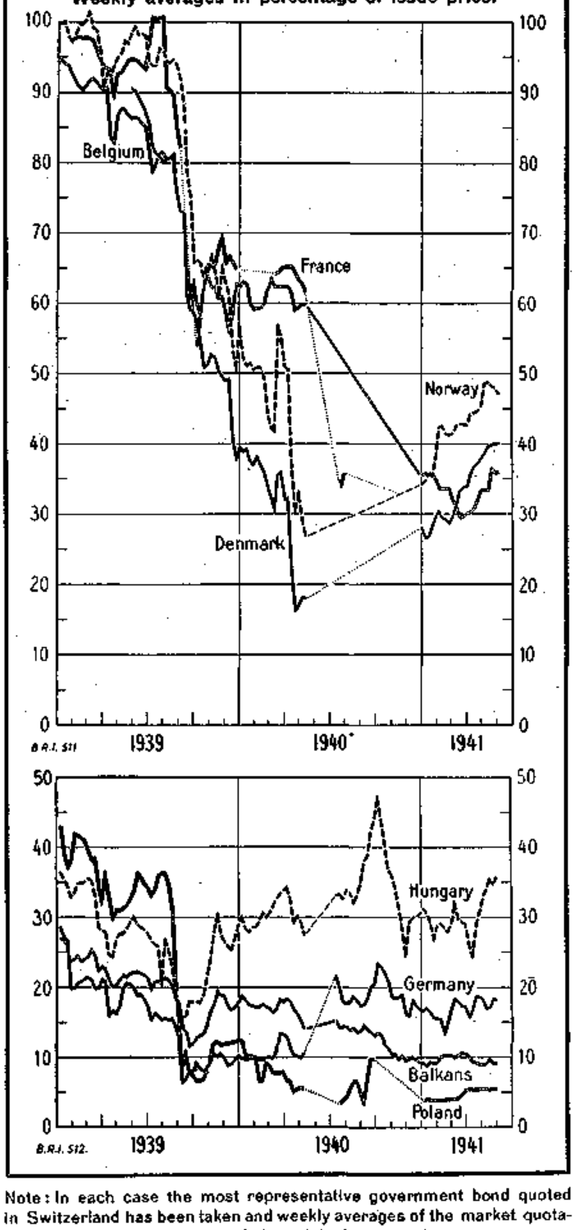
During 1940 the Bank made three loans totalling $95 million to the Chinese Government and the Bank of China, of which $50 million was for currency stabilisation to be repaid over a period of years by Chinese exports of strategic and other materials needed for United States defence. Further credits for currency stabilisation were granted by the U. S. Exchange Stabilization Fund in 1940, which made $50 million of dollar exchange available to China, $50 million to the Argentine and up to $60 million to Brazil. The British Government also granted a loan of £10 million to China, £5 million being for currency stabilisation and £5 million available for commodity purchases within the sterling area.

Of particular interest was the loan made in December 1940 by the National City Bank of New York to the Banco Central de Venezuela, to clear up blocked exchange and facilitate foreign trade — an exceptional example of a resumption in the flow of new private capital from the United States towards South America, which had completely dried up in recent years. There was also a successful public offering of $4 million 26-year 3½ per cent. refunding bonds of the Republic of Panama in New York at the end of March 1941. This was the first public offering of foreign bonds in the United States, except for Canadian government issues, since the Argentine floatation in November 1938.

Apart from the cases mentioned above, foreign credit operations have been practically confined to the renewal and repayment of old credits. The Swiss banks' credit of Sw.fcs 40 million to the Argentine Government was prolonged for a further six months in December 1940. German standstill agreements continue to run with Switzerland and the United States, interest being still transferred; with Holland the introduction of free capital transfers from 1st April 1941 has made an agreement superfluous, and with Belgian banks separate arrangements on the basis of long-term credits have been made: the aggregate of RM 6,300 million standstill debts in 1931 has now been reduced by repayments in registered marks or by currency depreciations to less than one-tenth (even including debts to England and France). Repayments and consolidations of the credit granted to the National Bank of Hungary by central banks and the Bank for International Settlements in 1931 are mentioned in the business section of this Report.

The thorny question of the current service of outstanding long-term foreign loans has become more complicated than ever. Changing political divisions in Europe and constantly modified bilateral agreements make it impracticable to give a detailed account in this Report. Broadly stated, there were, early in June 1941, very little debt service payments in cash on private or public foreign bonds of continental European countries to countries outside the continent, with some exceptions, e. g. Sweden and Switzerland and, in spite of difficulties, Denmark and Finland. Portugal, in an exceptionnally favoured position, was able to extinguish its external government debt of some £27 million 3 per cent. bonds (which were, indeed, held almost wholly within the country) by exchange into an issue in the domestic currency made from April 1940 onwards. Inside Continental Europe itself, service of the same foreign loan may differ from one creditor country to another according to specific payments agreements covering foreign trade relations and other items of the bilateral balance of payments. Defaults, partial or total, and delays and interruptions in service have been frequent. The two accompanying graphs, showing quotations of certain typical foreign bonds on the bourses, give some idea of the experience of Swiss creditors. Only in the case of German bonds (Young Loan) were quotations somewhat higher on the year 1940. Certain European countries with representatives abroad (such as Belgium, Holland and Norway) have maintained the foreign debt service to creditors outside Continental Europe, principally the United Kingdom and the United States, from resources held outside the continent. The service of French loans in the United States has been assured from dollar assets previously blocked. Payments on Japanese external bonds have been maintained as usual, but the foreign debt service on China's large older loans secured on customs, salt and railway revenues has remained in complete default throughout the year. As regards South America, the most important event was the resumption of service on the Brazilian Government's foreign debt, on the basis of the Aranha Plan of 1934, thus putting an end to the default which had persisted since 1937. At the end of 1940 the percentage of the $6,000 million outstanding foreign dollar bonds in default had risen to 41.9 from 38.5 at the end of 1939.

Foreign Bond Quotations in Switzerland.
Weekly averages in percentage of issue price.



Note: In each case the most representative government bond quoted in Switzerland has been taken and weekly averages of the market quotation given as a percentage of the original issue price.

War conditions, with exchange restrictions made more watertight, foreign assets immobilised in the United States and elsewhere and foreign trade under control, put almost insuperable obstacles in the way of private financing outside the limits of each individual country. Such international credits as are granted are therefore practically all derived from government funds or from official agencies and, as must be the case in such circumstances, are given mainly for political purposes, whether to assist in the war effort directly or to develop trade in desirable directions. The volume of foreign indebtedness, which in 1930 had risen to considerable proportions, was greatly reduced in the years prior to the outbreak of war, through repayments, currency depreciations, repatriations etc. The present increase in international indebtedness (largely inter-governmental in character) coincides with other great changes in the world's capital structure (mobilisation and realisation of foreign investments, etc.). What the net result of these changes will be cannot yet be foreseen, but difficult problems are undoubtedly being created which will reveal themselves in all their stringency when the war is over. In the immediate post-war period, when the need of foreign raw materials and foodstuffs will be intense in many areas, a rapid resumption of private international financing, now at a standstill, may well prove impossible and the task of providing the necessary resources may still fall upon public agencies. Some governments are clearly making great efforts to maintain their credit standing by payments of service on their foreign debts. Movements of goods without the aid of credit will necessarily be limited and unsatisfactory and, for that reason alone, the problem of arranging adequate international financing will have to be tackled with promptitude in order to prevent avoidable calamities once the war is over.

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

1. GOVERNMENT FINANCE, MONEY AND CAPITAL MARKETS.

Government financing dominated the money and capital markets throughout the world in 1940, not only in the belligerent countries but in neutral states and occupied territories also. Only in rare instances were other factors important, as for example the financing of clearing claims in Denmark and Slovakia and the repatriation of dollar balances to Switzerland. Budget deficits caused by the war were financed in the first months by both Germany and England almost wholly at short term, but more recently large long and middle-term loans have been placed, so that in both cases government borrowing in the six months to March 1941 was about half at long and half at short term. In Italy considerable conversion and consolidation issues have been made to reduce the floating debt, swollen through the budget deficits of recent years. In most other European countries budget deficits due to armament expenditure, occupation costs or efforts at reconstruction have been financed largely at short term, in some cases through a considerable expansion of bank (including central bank) credit. Overseas, a vast programme of armament expenditure has been approved in the United States and actual expenditure grows monthly at an accelerating pace: in Japan the financing of the war with China has provoked increasing budget deficits and continuous government bond issues for nearly four years.

The war has not put a stop to the era of cheap money except in temporary and isolated cases. Long-term rates of interest have fallen over the year in the United States and in Germany, England and some other European countries, including territories occupied by Germany after the campaign in the spring and summer of 1940. In Sweden the official discount rate was raised by ½ per cent. in May 1940, this being the only increase of bank rate in the world during the year (if the readjustment of bank rate in the Protectorate of Bohemia and Moravia to the German level be omitted); eight out of twenty-one European bank rates were lowered during 1940, the most important consideration in each case being to enable the governments to borrow at lower cost.

In Germany the technique of war financing was perfected in peacetime and, whereas other countries were forced to improvise new methods, at least in the first months of the war, the change in Germany was rather one of degree and the transition a smooth one. The total revenue of the Reich from taxation and borrowing rose considerably on the outbreak of war and at the end of 1940 was more than double that of the last quarter of 1938. The financial year runs from April to March and the following table gives quarterly figures for the past three years.

Reich receipts from taxation and borrowing.

Quarterly in millions of RM	Taxation	Borrowing	Total	Percentage of total from taxation
1938 April–June	3,671	3,447	7,118	51.6
July–September	4,633	1,407	6,040	76.7
October–December	4,718	3,449	8,167	57.8
1939 January–March	4,669	2,535	7,204	64.8
1939 April–June	5,221	3,738	8,959	58.3
July–September	6,179	5,074	11,253	54.9
October–December	6,335	6,102	12,437	50.9
1940 January–March	5,840	6,159	11,999	48.7
1940 April–June	6,067	8,134	14,201	42.7
July–September	7,351	9,575	16,926	43.4
October–December	6,987	9,819	16,806	41.6
1941 January–March	6,816	10,309	17,125	39.8
Financial years 1938–39	17,691	10,838	28,529	62.0
1939–40	23,575	21,073	44,648	52.8
1940–41	27,221	37,837	65,058	41.8

This table does not show all budgetary receipts although it covers over 90 per cent. of internal budget revenue. The war contribution of the local authorities to the central government, due to economies of administration up to one-half, gave a further RM 1.25 milliard in 1940–41 and, with net receipts from public enterprises etc., made up some RM 3–4 milliard in addition to the tax revenue shown in the table.

Of the total budgetary receipts, amounting to, say, RM 68–69 milliard in 1940–41, less than one-fifth was needed to cover civil expenditure, the balance being devoted to the war effort. Besides this internal budget revenue, contributions are received from the occupied territories in the shape of occupation costs, which for France, for instance, were at the rate of RM 7,300 million annually: the returns of the Bank of France show, however, that up to the end of 1940 less than half had been effectively utilised. Official estimates of revenue for the financial year 1941–42 give the income from taxation at RM 30 milliard, administration receipts at RM 5 milliard and the war contribution of the local authorities at RM 1.4 milliard. The addition of the "Matrikular" contribution of the Protectorate and the occupation costs from occupied territories raises the total current revenue (apart from borrowing) above RM 40 milliard.

Some forms of taxation receipts and customs revenue may be expected to fall off in wartime but other tax income has increased to take their place. Since the outbreak of war a 50 per cent. supplement has been added to income tax and war increases have been made to taxes on beer, wines and tobacco. Official statements have been issued to the effect that no new taxes and no further increases in the rates of present taxation are to be made in 1941 and that no "war loans" are to be publicly offered on the open market. Actually wartime borrowing has been effected "noiselessly" through the intermediary of banks and other institutions. A quarterly analysis of Reich borrowing is given below. As far as possible only cash receipts are shown but, as the notes indicate, the total figures may slightly exceed the actual cash proceeds of issues made.

Reich Internal Debt — quarterly increases or *decreases* (—)*.

Quarterly in millions of Reichsmarks	Short-term				Long and middle-term					Tax certificates	Grand total
	Reichsbank (1)	Treasury bills etc. (2)	Sundry short loans (3)	Total (4)	Rentenbank (5)	Market issues (6)	"Liquidity loans" (7)	Sundry loans (8)	Total (9)	(10)	(11)
1938 April–June .	(– *73*)	1,230	—	1,157	—	1,932	396	(– *38*)	2,290	—	3,447
July–Sept. .	35	1,216	—	1,251	—	(*–1*)	405	(–*248*)	156	—	1,407
Oct.-Dec. .	42	209	9	260	—	3,018	365	(–*194*)	3,189	—	3,449
1939 Jan.-March	(– *73*)	1,605	(– *10*)	1,522	—	423	748	(–*158*)	1,013	—	2,535
1939 April–June .	73	1,090	281	1,444	—	(– *33*)	964	(–*135*)	796	1,498	3,738
July–Sept. .	119	2,128	(–*281*)	1,966	400	—	253	(– *77*)	576	2,532	5,074
Oct.-Dec. .	567	3,628	—	4,195	274	—	1,082	(– *90*)	1,266	641	6,102
1940 Jan.-March	(–*470*)	4,381	—	3,911	117	741	2,173	(–*114*)	2,917	(–*669*)	6,159
1940 April–June .	370	3,726	634	4,730	75	1,967	1,766	(– *17*)	3,791	(–*387*)	8,134
July–Sept. .	*59*	4,738	874	5,553	—	2,383	1,696	2	4,081	(– *59*)	9,575
Oct.-Dec. .	(– *46*)	4,508	—	4,462	60	2,717	2,597	(– *8*)	5,366	(– *9*)	9,819
1941 Jan.-March	(–*400*)	5,421	410	5,431	—	3,777	1,312	(–*209*)	4,880	(– *2*)	10,309
Financial years											
1938–39 . .	(– *69*)	4,260	(– *1*)	4,190	—	5,372	1,914	(–*638*)	6,648	—	10,838
1939–40 . .	289	11,227	—	11,516	791	708	4,472	(–*416*)	5,555	4,002	21,073
1940–41 . .	(–*135*)	18,393	1,918	20,176	135	10,844	7,371	(–*232*)	18,118	(–*457*)	37,837

* Only the "new" internal debt is taken into account, i. e. that contracted since 1924. Further, the increases of nominal amounts outstanding are given, which of course slightly exceed the cash proceeds when loans or bills are issued at a discount. See also the note under (8) below.

(1) Working credit, the RM 100 million limit of which was removed in June 1939. Although no new limit has been published, the total borrowed at any particular time is understood never to have exceeded RM 1,000 million.

(2) Including certain other short-term financing, in particular the six-month "delivery bills" issued from April 1938 to April 1939 and completely repaid by October 1939. Net amounts are given taking account of a decrease over the three years by about RM 200 millions of Treasury bills "zur Sicherheitsleistung", not necessarily a cash item.

(3) In April and May 1939 a special "over-bridging" credit from the banks. Later the debt of the Reich to the central administration of the Reichskreditkassen is included under this item.

(4) Total short-term borrowing.

(5) Loan to Reich corresponding to issue of Rentenmark notes to supplement the coin circulation.

(6) No market issues were made in 1939, the amounts shown in the January-March quarter being delayed subscriptions to the loan of December 1938. For 1940 the issues of 4 per cent. Treasury certificates (and for 1941 the 3½ per cent. certificates) have been entered in this column.

(7) Issues made directly to employ the liquid resources of savings banks, insurance companies, social funds etc.

(8) Under this heading is placed the quarterly movement of all other long and middle-term indebtedness, excluding only the loans of 1938 and 1939 issued to compensate German holders of Austrian and Czecho-Slovakian government loans, amounting to RM 1,395 million up to the end of March 1941. There is included, however, about RM 300 million for agricultural debt clearance and the liquidation of the Austrian National Bank, which had no counterpart in cash receipts for the Treasury. The principal factor in this column is the redemption and amortisation of loans not shown in columns (6) and (7), which are given n e t i. e. with current amortisation deducted.

(9) Total outstanding of all long and middle-term issues.

(10) *Tax certificates utilised for payments in accordance with the New Finance Plan of 1939 – not, therefore,* wholly cash receipts but supplementing general revenue. Repayments are made by surrender in payment of taxation but for convenience it is desirable to include these certificates under borrowing (a point to be remembered when comparing the receipts from taxation and borrowing given in the previous table.)

(11) Total borrowing as shown in previous table.

The total public debt of the Reich (excluding tax certificates) rose, according to the published statements, from RM 19 milliard at the end of March 1938 to RM 34 milliard at the outbreak of war and RM 86 milliard at the end of March 1941 (of which RM 38 milliard was at short term). The division in the table into short as contrasted with middle and long-term has been made in accordance with the official statistics. In the calendar year 1938 huge market issues were made and long-term financing preponderated. Short-term issues, particularly Treasury bills, became more important in 1939, especially if account be taken of the six-month tax certificates (one-half of the total).

Large issues of Treasury bills were made in 1940 but the volume of long and middle-term loans also grew, so that receipts from borrowing of RM 20 milliard in the last six months of the financial year 1940–41 were divided almost equally between long and short-term issues. Classified under long-term "market" loans in 1940 are the new issues of 4 per cent. Treasury certificates, the earlier tranches of which were of only 5 years' while later tranches were up to 20 years' maturity. A remarkable feature of the year was the large amounts invested in government bonds by savings banks, insurance companies and similar institutions (the so-called "Liquidity loans") reflecting the accumulation of small savings. Deposits in savings banks alone passed the level of RM 33 milliard in 1940 against only RM 22 milliard in the middle of 1939, RM 2 milliard of the increase being due to the inclusion of Ostmark and Sudeten banks in the 1940 figures. A further feature was the small amount taken by direct advances from the Reichsbank (included in the Bank's return under "Sundry assets", which also comprise the direct advances to the Reichspost and Reichsbahn).

German Reichsbank Return.

At end of quarter in millions of RM	Assets			Liabilities	
	Bills and cheques	Securities	Sundry assets	Note circulation	Deposits etc.
1938 December	8,244	855	1,488	8,223	1,527
1939 March	8,180	969	1,329	8,311	1,249
June	8,159	1,203	1,514	8,731	1,281
September	10,105	1,716	1,604	10,995	1,602
December	11,392	1,197	2,033	11,798	2,018
1940 March	12,242	537	1,822	12,176	1,760
June	12,611	597	1,863	12,785	1,854
September	13,206	472	1,797	12,847	1,795
December	15,419	389	1,726	14,033	2,561
1941 March	15,367	385	1,246	14,188	2,127

Actually the "working credit" of the government was reduced on balance during 1940 by RM 205 million to RM 580 million, while the item "securities" fell as government bonds were sold on the stock exchange. On the other hand, the volume of "bills and cheques", mostly Treasury bills and thus representing indirect government borrowing, rose by RM 4 milliard on the year. The rise of the note circulation in 1940 is largely accounted for by the territorial expansion and by the slower circulation of money and the maintenance of higher cash reserves. Treasury bills issued by the government during the year 1940 amounted to RM 17.4 milliard (raising the total in circulation to RM 30.7 milliard). Some RM 13.4 milliard Treasury bills were thus placed outside the Reichsbank, mostly with the other banks, which experienced a remarkable increase of deposits during 1940 parallel to the rise of Treasury bills and securities.

German Banks' Balance-Sheet Items.

At end of year in millions of RM		Assets				Liabilities
		Bills and cheques	Treasury bills	Securities	Advances	Deposits etc.
A. Five big Berlin Banks (1)	1937	2,620	365	617	3,012	6,781
	1938	2,243	1,229	768	3,223	7,627
	1939	2,137	2,563	488	3,416	8,803
	1940	2,282	3,793	1,300	2,715	11,699
B. Four special Banks (2)	1937	1,311	566	529	298	2,833
	1938	1,471	749	532	416	3,296
	1939	985	3,071	455	475	5,103
	1940	1,504	4,701	828	640	7,846
C. Total nine Banks	1937	3,931	931	1,146	3,310	9,614
	1938	3,714	1,978	1,300	3,639	10,923
	1939	3,122	5,634	943	3,891	13,906
	1940	3,786	8,494	2,128	3,355	19,545

(1) Deutsche Bank, Dresdner Bank, Commerzbank, Reichskreditgesellschaft and Berliner Handelsgesellschaft.
(2) Deutsche Girozentrale, Preussische Staatsbank, Deutsche Zentralgenossenschaftskasse and Bank der Deutschen Arbeit.

Besides the acquisition of Treasury bills, an important factor during the year was the extension of the banks' business to incorporated and occupied territories. Deposits with the five Berlin Grossbanken grew by one-third in 1940 and with the four special banks by over one-half. It has been estimated that the deposits with all reporting banks at the end of 1940 were about RM 33–35 milliard against RM 21 milliard in July 1939, when the last monthly return was published, an increase of RM 12–14 milliard, mostly against Treasury bills. In the same period the total Treasury-bill issue rose by RM 23 milliard, of which about RM 7 milliard was placed with the Reichsbank and RM 16 milliard with banks and other market institutions. Significant as a sign of the liquidity of the economy as a whole and of the change of structure of the banks is the fall of advances in 1940, which is particularly marked for the three banks with widespread commercial business (the Deutsche, Dresdner and Commerz Banks) and amounts to over 20 per cent. on the year. Each of these three big Berlin banks with a network of branches throughout the country increased its capital during the year to keep pace with the increase of total liabilities. The capital and reserves of all German reporting banks amounted to RM 2½ milliard with RM 21 milliard deposits in July 1939 against RM 4½ milliard with RM 11½ milliard deposits in 1913. The problem of raising capital resources when profits are tending to fall with the narrowing margin of interest rates is similar to that in the United States — and, as in that country, emphasises the importance of building up reserves. In both cases the solvency of the banks and the protection of depositors are assured rather by the high level of the banks' first-class liquid assets than by the volume of nominal capital.

The issue of Treasury bills, which has reached comparatively large proportions, has been an important factor making for pronounced liquidity in the banks and on the money market. The Reichsbank reduced its discount rate to 3½ per cent. on 9th April 1940 from 4 per cent., at which it had stood since September 1932.

The extent of the reduction of interest rates in Germany since the beginning of the war may be seen from the following table.

German market rates.

In percentages	At outbreak of war	Beginning of 1941	Reduction
Share yields	5.20	3.80	1.40
"Liquidity loans" and longer-term Treasury certificates.	4.50	3.50	1.00
17–18 months' Treasury bills	3.75 (1)	3.00	0.75
"Block bills" of 360 days	3.56	2.75	0.81
6–7 months' Treasury bills	3.25 (2)	2.50	0.75
Private discount rate	2.75	2.25	0.50

(1) 12–13 months' bills. (2) 4–5 months' bills.

The liquidity of the economy is reflected also in the long-term market. Perhaps the most striking illustration of this is found in the terms of issue of Treasury certificates; the first issue at 99 of 4 per cents (for five years) in March 1940 gave a yield of 4.33 per cent., while early in January 1941 it was possible to make a 3½ per cent. issue (for 15 years) at 98¾ with a yield of 3.63 per cent. In the first part of 1940 the market for Reich long-term loans had had moments of weakness, when the possibility of converting the 4½ per cent. issues to a lower interest rate was under discussion. The Reichsbank increased its holding of securities by RM 100 million between 7th March and the end of April 1940 but was able to sell in later months, and by the end of the year its total holding was very low (under RM 390 million).

These conditions were favourable to the issue market and advantage was taken for the placing of industrial loans connected with the financing of the war effort. The largest bond issues occurred in the first quarter of 1940, while during the latter part of the year there was a noticeable shift in financing in favour of shares.

Germany — Industrial share and bond issues.

In millions of RM	Shares	Industrial bonds	Total
1940 January–March	66	399	465
April–June	232	212	444
July–September	179	229	408
October–December	385	43	428
1941 January–March	1,304	—	1,304

Source: Frankfurter Zeitung. Bond issues are nominal amounts but for shares the total estimated proceeds of the issue including premiums are given.

In the first quarter of 1941 there were no industrial bond issues while the placing of shares exceeded RM 1,300 million — more than the total in any recent year.

In Germany, as in other countries, there has been some discussion regarding the social effects of very low interest rates, especially on small savings invested, for example, through life assurance companies. The following table shows the shift which has taken place in the assets of the larger private insurance companies in Germany.

German Insurance Companies' Investments.(1)

In millions of Reichsmarks	Number of companies	Real property	Mortgages	Loans to public bodies	Securities	Total investments
1913	67 (2)	104	4,669	253	174	5,640
1933	267	387	2,368	350	1,014	4,437
1938	258	739	2,713	697	2,683	7,261

(1) Source: Frankfurter Zeitung. (2) Life and sickness insurance only.

Mortgages in 1938 represent only 37 per cent. of total investments compared with 83 per cent. in 1913. Securities, on the other hand, have risen from 3 per cent. in 1913 to 37 per cent. in 1938. It is difficult to calculate the real yields owing to the considerable invisible reserves but it is pointed out that, whereas total investments doubled from 1931 to 1938, investment income rose by only two-fifths, so that there has been a fall of nearly one-third in the overall yield. In this connection it may be recalled that an official statement was made in February 1941 that there was no intention, for the time being, of seeking a general lowering of the current standard rate of 3½ per cent. for Reich borrowing.

The most important event from a financial point of view in the Protectorate of Bohemia and Moravia was the customs and monetary "Anschluss" with Germany on 1st October 1940, by which the Protectorate came within the German system of customs and foreign exchange restrictions. During the year the market was under the influence of increasing liquidity due chiefly to the surplus of exports, for the most part to the Reich (while clearings with other countries were also made through Berlin in Reichsmarks). The easy conditions are illustrated in the National Bank's return by the almost complete disappearance of internal credit business at the end of the year, the rise of "other sight liabilities" and the increased circulation of "Bons de caisse", issued since the second half of 1938 to mop up surplus funds on the market.

National Bank of Bohemia and Moravia.

At end of month in millions of Kronen	Assets			Liabilities		
	Gold and foreign exchange	Internal credit	"Sundry assets"	Note circulation	Other sight liabilities	"Bons de caisse"
1938 December .	3,942	3,550	1,045	6,950	656	395
1939 December .	2,402	1,896	3,791*	6,345	1,054	525
1940 September .	2,494	710	5,345	5,976	969	931
December .	2,232	24	7,816	6,453	1,560	1,002
1941 March . . .	2,234	250	8,444	7,007	2,051	1.320

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

In order to fall into line with the Reichsbank, the National Bank's official rate of discount was raised from 3 to 3½ per cent. on 1st October 1940, while other rates in the country were similarly adjusted. During the year the regulations governing the National Bank were modified to exclude from the primary cover provisions those Protectorate notes issued against German currency and other claims in Reichsmarks, including Reich Treasury bills and certificates which the Bank was also authorised to discount or purchase.

The Italian budget has shown a deficit since the year ending 30th June 1931 (financial year 1930–31), but it was only from the time of the Abyssinian campaign (beginning October 1935) that "exceptional" military expenditure took a prominent part in the budget outlay. Recent closed budget figures have been as follows.

Italian Budget Accounts.

In milliards of lire	Revenue	Total expenditure	Deficit	"Exceptional" expenditure (1)
Four years' average 1930–31 to 1933–34	19.0	22.6	3.6	—
1934–35	18.8	20.8	2.0	1.0
1935–36	20.4	33.1	12.7	11.1
1936–37	24.7	40.9	16.2	17.5
1937–38	27.5	38.6	11.2	9.0
1938–39	27.6	39.9	12.3	6.5
1939–40	32.4	60.4	28.0	21.9
1940–41 (2)	31.0	96.0	65.0	. .

(1) Included in total expenditure (column two). (2) Estimates of the Ministry of Finance.

Expenditure rose, prior to the present war, for a number of reasons, of which the most important were the costs of the Abyssinian campaign, the empire development schemes, the Spanish war, the union with Albania, the policy of autarky and rearmament. "Exceptional" expenditure, which was high in the two years to June 1937, was compressed in the following two years and the budget deficit somewhat reduced. But, in spite of a 50 per cent. increase of revenue over the five years from 1934–35, the heavy "exceptional" expenditure in the year 1939–40 (which includes the first three weeks of active warfare) raised the deficit again to a record figure. Expenditure for the financial year 1940–41 was estimated at Lit. 96 milliard and the deficit at Lit. 65 milliard, say Lit. 5½ milliard a month. On the commencement of hostilities the estimate of the monthly deficit was raised to Lit. 10 milliard. But from over Lit. 7 milliard in July 1940 the deficit fell to Lit. 5.6 milliard in December and Lit. 5.4 milliard in March 1941, so that the original estimates have been maintained. The extent of the Italian effort may be realised by comparison of these figures with the national income, which was estimated for 1939 at Lit. 125 milliard.

The aggregate deficit of Lit. 82 milliard in the six financial years 1934–35 to 1939–40 has been covered by borrowing at long and middle term and at short term in about equal proportions. The proceeds from the longer-term borrowing were as follows:

	Lit. milliard
Reconversion to 5 per cent. of a loan previously converted to 3½ per cent. (holders being required to take up new Treasury certificates for cash equal to 15 per cent. of the holding converted)	6.8
Real estate redemption loan (covered by special tax on land-owners)	6.4
Special 5 per cent. Treasury bonds (1944) issued against realised external assets	2.8
Nine-year bonds 4 per cent. (1943)	2.0
Nine-year bonds 5 per cent. (1949)	22.0
Total	40.0

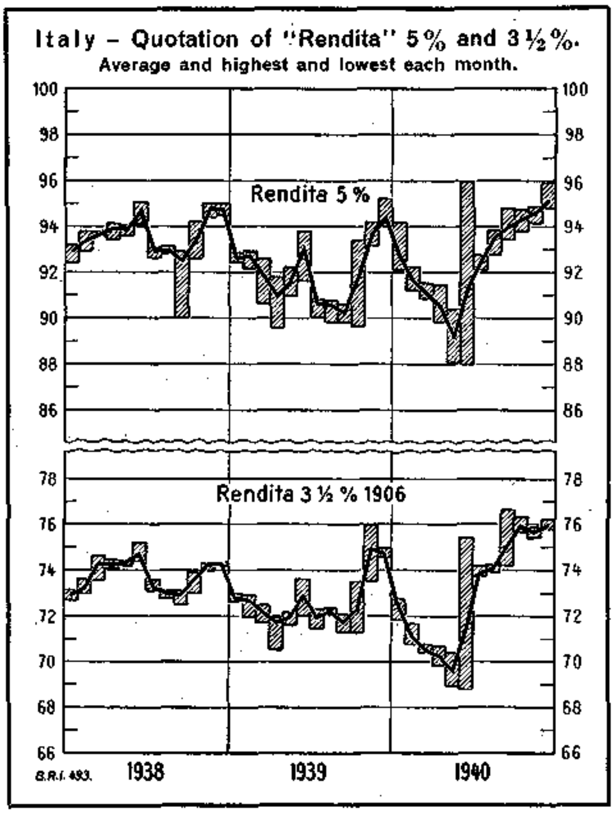
5 per cent. nine-year bonds (1949) were issued in February 1940 to a total of Lit. 28 milliard, of which at least Lit. 10 milliard was new money: of the balance, Lit. 6 milliard was accounted for by the conversion of the 1931 bonds and the 5 per cent. National Loan of 1916, the remainder of Lit. 12 milliard representing consolidation of advances previously granted to the government by the Cassa Depositi e Prestiti (the central organisation of the savings banks). Similarly, the floating debt expanded in the six years by about Lit. 40 milliard, of which some Lit. 8–9 milliard was on account of the current advances of the Cassa Depositi e Prestiti (in addition to the amount consolidated as above) and of other official institutions, Lit. 16–17 milliard was issued as one-year Treasury bills and the remainder, say Lit. 15 milliard, was covered by other Treasury resources and the extension of central bank credit. No detailed statistics of the public debt have been published since June 1935, when the total internal debt was Lit. 105 milliard, of which Lit. 12 milliard was floating debt. At the end of June 1940, the total debt was estimated at about Lit. 170 milliard, of which Lit. 40–45 milliard would be at short term.

The note circulation, which fell from Lit. 18 milliard at the time of the stabilisation of the currency in 1927 to under Lit. 13 milliard in the middle of 1935 (before the Abyssinian campaign), rose subsequently as the following table shows.

Banca d'Italia — some items from the balance sheets.

At end of year in milliards of lire	Assets				Liabilities		Total of balance sheet
	Private credit			Advances to govern-ment	Notes	Current accounts and sight bills	
	Bills	Advances	Total				
1937	2.5	4.5	7.0	1.0	17.5	1.4	21.5
1938	3.7	3.7	7.4	3.0	19.0	1.7	23.6
1939	4.8	3.0	7.8	9.0	24.4	2.5	29.6

In the two years up to the end of 1939, Lit. 8 milliard was advanced direct to the government, there being a corresponding increase of the Bank's total sight liabilities. In the first nine months of war about ten per cent. of the total borrowing of Lit. 50 milliard (three-quarters of the estimated deficit of Lit. 65 milliard) was from the central bank. On this basis the note circulation in March 1941 was estimated at a minimum of Lit. 30 milliard (the advances to the government being some Lit. 15 milliard).



Bank rate has been maintained without change at 4½ per cent. since May 1936, but conditions have shown considerable temporary changes, which are reflected in the following graph of the quotations of two important government securities.

The money market was somewhat tight in the first half of 1940, in part, at least, on account of borrowing to build up stocks and to meet the heavy direct taxation. In the second half of the year, conditions became much easier with the liquidation of stocks and heavy government spending. The government began the issue of Treasury bills for maturities of one to twelve months (previous issues being for a minimum period of one year), subscriptions averaging about Lit. 1½ milliard a month. The increase in the commercial banks' holdings of bills and of deposits is illustrated by the following table, giving some figures from the aggregate balance sheets of three important banks.

Italy — three big commercial banks,*
some important items from the balance sheets.

At end of year in millions of lire	Assets				Liability	Total of balance sheet
	Cash (1)	Bills (2)	Advances and overdrafts (3)	Government securities (4)	Deposits (5)	(6)
1938	1,961	10,139	5,917	1,437	17,430	21,751
1939	2,537	10,491	6,626	1,560	18,882	23,716
1940	2,635	12,812	7,408	1,355	21,714	27,472

* Banca Commerciale Italiana, Credito Italiano and Banco di Roma.
(2) Discounts, Treasury bills and sight credits.
(3) Debtor current accounts and correspondents.
(4) Includes both government and government-guaranteed securities.
(5) Including current accounts and savings deposits, creditor current accounts and correspondents.

In round figures, bills discounted, Treasury bills and sight credits rose during 1940 by Lit. 2,300 million and advances by Lit. 800 million, while long-term government securities have actually declined by Lit. 200 million; it is evident that these commercial banks have not been heavily called upon for government financing purposes, government securities being largely subscribed by the savings banks and the public. The task of intermediate financing of the war industries is entrusted particularly to the special semi-official institutions such as I. M. I. (Istituto Mobiliare Italiano), the I. R. I. (Istituto per la Ricostruzione Industriale) and the Consorzio Sovvenzioni.

A tendency of saved income to rise more rapidly than consumed income has been noticeable in Italy in recent years. In 1937 the increase of total deposits with credit and savings institutions, (not including new net investments of insurance companies etc.) was estimated at about Lit. 5 milliard, and in 1939 at over Lit. 8 milliard (compared with a national income then about Lit. 100 milliard). It is likely that in 1940 the increase in earnings, together with restrictions on consumption and dividends, has caused a further expansion of savings. In February, 1941, Italy's first war loan, an issue of 5 per cent. nine-year premium bonds, was made at 97½ to cover maturing 1932 bonds for about Lit. 4 milliard and to provide new money. By 12th March, Lit. 18.85 milliard had been subscribed, of which Lit. 15.25 milliard was in cash.

In the countries occupied by Germany after the campaign in the spring and early summer of 1940 certain similarities in the line of development may be traced. Emergency government financing (generally involving drawing on the central bank) to cover the suddenly increased outlay, partial moratoria, restrictions on the withdrawal of bank deposits and closing of stock exchanges were followed by the use of German means of payment (Reichskreditkassenscheine) by the advancing German troops. With the occupation completed, German commissioners were appointed to the central banks and the Kassenscheine were kept in use until arrangements had been made for payments in local currencies by the German authorities; the banks were fully opened, moratoria were lifted and the stock exchanges gradually resumed activity. The local currencies were closed to outside influences by exchange restrictions and rates were fixed with the Reichsmark as well as with other currencies. Taxes began to flow in again and government financing became more normal but generally some central-bank credit continued to finance the clearings with Germany and to cover occupation costs; thus note circulations and commercial banks' cash reserves rose, bank deposits expanded, the markets increased in liquidity and interest rates fell.

The issue of Reichskreditkassenscheine and the fixing of exchange rates between them and the currencies in occupied territories have been described in chapter II (1). From a credit point of view the function of Reichskreditkassenscheine in the north and west of Europe differed from that in Poland. In the latter country the banking system was completely paralysed and the Kassen were called upon for credit facilities as well as for currency. Thus they fulfilled, for a time, certain central-bank functions, which was not, or hardly ever, the case in the west. In Denmark and Norway, where no Kassen were opened, since the banking system remained intact, the Reichskreditkassenscheine which had been issued were gradually withdrawn as they came back to the central banks, with which arrangements had been made to provide the German troops with local currency. Similar arrangements were made in Holland, Belgium, Luxemburg and France, where, however, the issues were greater and the withdrawal of the Reichskreditkassenscheine more protracted.

Denmark and Norway were occupied by Germany in April, Belgium and Holland in May, and the north and west of France in June 1940. The principal causes for the change in the credit situation in Denmark since April 1940 are best shown by a table giving the main alterations in the return of the central bank.

Danmarks Nationalbank Return.

End of month in millions of kroner		December 1939	March 1940	March 1941	Change on year March 1940–March 1941
Assets	Clearing assets	—	—	498	+ 498
	Sundry debtors	47	47	561	+ 514
	All other assets (1) . .	905	818	414	— 404
Total of balance sheet		952	865	1,473	+ 608
Liabilities	Note circulation . . .	600	609	707	+ 98
	Sight deposits (2) . . .	134	75	554	+ 479
	All other liabilities . .	218	181	212	+ 31

(1) Including the gold reserves and internal credit items. (2) Including current accounts.

Danish exporters through the clearing are paid directly and the foreign claims taken over by the National Bank. A large surplus of exports of agricultural products to Germany has led to a piling-up of clearing claims against which imports have not been made. In March 1941 there were net foreign exchange and clearing assets of Kr. 513 million against all countries, compared with a net debt of Kr. 36 million a year before. The item "Sundry debtors", which includes the claims on the Reichskreditkassen for Kassenscheine redeemed by the National Bank and also the financing of the occupation costs, has grown in a similar measure. Together the two items have risen by over Kr. 1,000 million during the year to March 1941. Of the Kr. 1,000 million new central-bank credit thus created, Kr. 400 million has been utilised to repay credit previously granted, Kr. 100 million has gone into circulation and nearly Kr. 500 million has piled up on sight account at the National Bank. The liquidity indicated by higher cash holdings and the repayment of debts is also reflected in the returns of the private banks.

Danish Commercial Bank Returns.

In millions of kroner		December 1939	March 1940	March 1941	Change on year March 1940–March 1941
Assets	Cash holding	211	129	614	+ 485
	Credit granted*	2,275	2,250	1,929	— 321
	Bonds and shares . .	454	430	670	+ 240
Liabilities	Current accounts . . .	843	702	939	+ 237
	Time deposits	1,612	1,647	1,747	+ 100

* Advances, overdrafts and bills discounted.

In May 1940 the government created a Kr. 100 million fund to guarantee, up to 50 per cent., advances made by the banks for the financing of industrial enterprises, but total advances nevertheless continue to fall. With deposits and cash rising and credit being repaid, the banks have employed part of their increased resources in the bond market (taking up securities sold by the National Bank to curb the expansion of its assets). Over the year bond prices have risen by 10 per cent. and the National Bank has twice reduced its discount rate, from 5½ to 4½ per cent. in May and to 4 per cent. in October 1940 (while parallel reductions have been made by the commercial banks on deposits and credit items). It is noteworthy that savings-bank deposits have not recovered. For the whole year 1940 they remained below the level of 1939.

Some small loans have been issued by the government but insufficient to put a check to the expansion of central-bank credit: a 3½ per cent. one-year loan of Kr. 40 million was placed with the banks in July; in October, Kr. 50 million was raised by 4 per cent. 10-year bonds issued to the public at 97¾; in February 1941, a 4 per cent. 25-year loan for Kr. 30 million was issued at 93½: Kr. 30 million of the second issue and all of the third was for redemption of maturing loans.

The situation in Norway is more difficult to illustrate owing to the *absence of the central-bank return, the last to be published being that of* 30th March 1940. This return showed the increase of tension, the note circulation having risen to Kr. 600 million compared with Kr. 480 million, the average for 1939. This tension grew in April, there being a run on bank deposits met by an increase of rediscounting at the central bank. From 16th April a moratorium was declared until 9th May. In that month a change took place: the Oslo bank's discount rate was reduced on 11th May from 4½ to 3 per cent., *with parallel reductions in the interest rates of the commercial and savings* banks. The easing of the situation was due to the relaxation of tension with the ending of the campaign and to the further extension of central-bank credit to the government. The note circulation continued to rise and was estimated at about Kr. 1,000 million at the end of the year, while the published returns of the commercial banks show a swelling of their cash resources.

Norwegian Commercial and Savings Banks (aggregate figures).

At end of month in millions of kroner	Deposits			Loans	Securities	Cash[2] reserves	Rediscounts[3]
	Sight[1]	Other	Total				
1938 December . .	146	2,834	2,980	1,680	1,021	100	1
1939 December . .	157	2,740	2,897	1,825	922	81	19
1940 March	209	2,768	2,977	1,871	915	71	47
December . .	554	2,636	3,190	1,579	1,001	441	1
1941 March	667	2,719	3,386	1,475	1,063	668	—

(1) At commercial banks only. (2) Including balances at Norges Bank. (3) Of commercial banks only.

The strain up to April 1940 and the complete change-over since the occupation are illustrated by the reduction of rediscounts and the huge increase of the banks' cash reserves. These reserves were generally about Kr. 50–80 million in the years up to 1937 and Kr. 80–100 million in 1938–39: anything over Kr. 100 million was exceptional. In the six months to March 1941 the increase has been at the rate of nearly Kr. 80 million a month. This increase of bank cash, accompanied by the repayment of loans and a rise in sight deposits at the commercial banks, must originate in the creation of central-bank credit, directly or indirectly, for account of the government. "Other deposits", which more directly reflect changes in genuine savings, have on the contrary fallen.

To finance the reconstruction, two loans were floated by the special institution charged with this task: at the end of June 1940 a 4 per cent. four-year loan for Kr. 50 million and in October a 4 per cent. five-year Kr. 75 million loan were issued to banks and insurance companies. In March 1941 the first government loan since the occupation was floated, the amount being Kr. 100 million in 3½ per cent. ten-year bonds.

The costs of mobilisation and other extraordinary expenditure in Holland caused an expansion of the floating debt (to the Nederlandsche Bank and the market) to its highest point of Fl. 630 million early in March 1940. In February a Fl. 300 million 4 per cent. 40-year loan was issued and in March Fl. 132 million was received as the government's share in the book profits on revaluation of the gold reserve. Thus, in April the floating debt to the market was reduced below Fl. 400 million; the government was out of debt to the Nederlandsche Bank and, in fact, had a credit balance in account.

Hostilities with Germany commenced on 10th May, whereupon restrictions on the withdrawal of bank deposits were imposed. The campaign was short and the Nederlandsche Bank published its weekly returns as usual, except that of 13th May 1940. The last return before the conflict showed no particular signs of tension: a comparison of this with later returns is given below.

Nederlandsche Bank Return.

In millions of florins	1939	1940			1941
	End Dec.	6th May	20th May	End Dec.	End March
Assets					
Sundry accounts . . .	29	21	21	123	212
Foreign bills	2	1	1	15	23
Loan to the government (1)	83	(-23)	15	261	175
Total (three items) . .	114	(-2)	37	399	410
Gold (2)	1,014	1,160	1,115	1,102	1,096
Domestic credit (3) . .	238	228	302	211	221
Other assets	65	65	60	71	71
Total of balance sheet	1,431	1,474	1,514	1,783	1,798
Liabilities					
Notes	1,152	1,159	1,261	1,552	1,593
Private accounts . . .	229	232	193	175	144
Other liabilities . . .	50	60	61	57	60

(1) Net, i. e. direct advances plus Treasury bills placed with the bank less credit on current account.
(2) Mostly abroad in 1940 and 1941. (3) Excluding credit to government.

In the two weeks to 20th May 1940 the call on the central bank was considerable; the government drew Fl. 38 million (withdrawing its deposit and taking a loan) and private customers (mostly the banks) Fl. 111 million (from deposits and credit granted) while Fl. 102 million went into circulation as notes. The tension soon abated, private credit was repaid and on 11th June the restrictions on the withdrawal of bank deposits (which had already been relaxed on 23rd May) were completely lifted.

Since the occupation, however, the monetary situation has been dominated by the excess of official financing over receipts, reflected in the considerable rise of three asset items in the balance sheet of the Nederlandsche Bank (shown at the top of the table). From 20th May to the end of December 1940 the aggregate increase of Fl. 362 million has its counterpart in a rise of Fl. 291 million in the note circulation and a net repayment of Fl. 73 million private domestic credit. Towards the end of July 1940 the Reichskreditkassenscheine, from being a purely supplementary currency, became an instrument for payments settled through the German-Dutch clearing and from August onwards increases of about Fl. 25 million a month took place in the "Sundry accounts" of the Nederlandsche Bank, which raised the total to Fl. 212 million at the end of March 1941. The two increases in "Foreign bills" corresponded exactly to RM 30 million at the official rate of exchange. Included in the two items "Sundry accounts" and "Foreign bills" are the Reichsmark claims of the Nederlandsche Bank. Besides financing the clearing balance and the occupation costs, the government has other extraordinary expenditure for war-damage compensation and unemployment relief, financed by short-term borrowing on Treasury bills and from the Nederlandsche Bank, as reflected in the item "Loan to the government" in the table. In Holland, unlike Denmark and Norway, the extension of central-bank credit has not led to any considerable repayment of old credit or to a swelling of cash reserves at the Nederlandsche Bank, but to an almost parallel expansion of the note circulation.

Dutch Treasury Position.

Quarterly in millions of florins (1)	Liquid asset: deposit at Nederlandsche Bank	Short-term borrowing outstanding		
		from Nederlandsche Bank (2)	from Market (3)	Total
1940 March. . . .	128	—	447	447
June	—	30	488	518
September .	—	112	796	908
December. .	—	251	1,059	1,310
1941 March. . . .	—	175	1,094	1,269

(1) Return dated 1st of following month.
(2) Advance, overdraft and Treasury bills directly placed.
(3) Treasury bonds, Treasury bills and, occasionally, call money.

Besides borrowing from the central bank, the government has placed a large volume of Treasury bills on the market, as the summary of the floating debt statement shows.

Treasury bills placed on the market have been largely taken up by the banks, whose holdings have increased.

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 March . . .	400	189	540
May	386	148	508
June	349	236	547
September .	311	425	674
December. .	286	517	756
1941 March . . .	313	514	768

Withdrawals of deposits in the first months of the year were met by a reduction of the Treasury-bill holding, in May below Fl. 150 million. From May 1940 to March 1941 deposits have risen by over 50 per cent., while private credit has been repaid and the Treasury-bill portfolio, having increased to more than three times its earlier volume, amounts to more than two-thirds of total deposits.

In contrast to the turn in the trend of commercial banks' accounts, savings-bank deposits, from February 1940, fell continuously throughout the year.

Holland — Postal and ordinary savings banks' deposits

In millions of florins	New deposits	Withdrawals	Movement
1937	473	390	+ 83
1938	489	432	+ 57
1939	390	471	— 81
1940	270	518	— 248

The net withdrawal of Fl. 248 million in 1940 represented nearly one-quarter of aggregate deposits in the savings banks at the end of 1939 and is doubtless one of the main reasons for the large volume of bank notes outstanding.

In January 1941 a comprehensive tax reform was undertaken and it is estimated that revenue from this source may be increased by 50 per cent. from the Fl. 800 million in 1940 to, say, Fl. 1,200 million in 1941. Government expenditure, however, is estimated, on the basis of recent borrowing, to be running at some Fl. 1,500–1,700 million a year above ordinary revenue. Ordinary expenditure is estimated at Fl. 900–1,000 million a year, public works and reconstruction at Fl. 200 million, the costs of occupation and expenditure for the German civil administration at Fl. 1,200 million. In addition, certain German orders to Dutch industry necessitate interim financing by the Dutch Treasury. In January 1941 a Fl. 500 million 4 per cent. ten-year loan was issued at par for the consolidation of the floating debt. If this loan did not prove a success a 2½ per cent. forty-year forced loan was to be raised. It was successful, however, and a temporary reduction of the floating debt was made in February 1941. The discount rate of the Nederlandsche Bank has remained unchanged at 3 per cent. since 29th August 1939 in spite of the extreme pressure (and bank moratorium) in the spring of 1940 and the comparative ease of the market at the end of the year.

The outbreak of the European war in September 1939 came as a shock to the money and capital markets in **Belgium**, weakened earlier in the year by an exchange crisis in the spring and bank failures in the autumn (following the Mendelssohn crash in Amsterdam): the 4 per cent. unified rente fell from around 85 in August to under 70 in November 1939. In the first months of 1940 there were signs of returning confidence — the unified rente rose to 80, and from January to March over B.fcs 2,000 million of the government floating debt was taken up by the market (thus relieving the National Bank).

Hostilities between Belgium and Germany commenced on 10th May 1940, whereupon the notes of the National Bank were made inconvertible and a credit of B.fcs 5 milliard was opened for the government. The commercial banks borrowed freely from the National Bank, to meet customers' requirements and to constitute cash reserves, but it was necessary to decree a partial restriction on the withdrawal of bank deposits (as on postal cheque accounts) from 13th May and to postpone bill protests, etc. The armistice came into force on 28th May. On 27th June the new Bank of Issue in Brussels was founded with a capital of B.fcs 150 million (20 per cent. paid up) subscribed by the Belgian commercial banks, but on 7th July the direction of the National Bank returned from abroad, where it had temporarily been operating, and in August the partial bank moratorium was lifted.

The weekly return of the National Bank was suspended from 8th May to 26th December 1940 inclusive, the Bank of Issue published no statistics before its balance sheet of 31st December 1940 and the circulation of Reichskreditkassenscheine was undisclosed. The National Bank has, however, published half-yearly balance sheets for 25th June and 25th December 1940 (and weekly returns from 2nd January 1941 are available for both the National Bank and the Bank of Issue). The following table summarises and combines the government debt statements with the statistics of the National Bank and the Bank of Issue:

Belgium — Combined Situation of National Bank and Bank of Issue.

End of month * in milliards of B.fcs	Assets					Liabilities	
	Gold	Foreign exchange	Government Debt		Credit to private economy	Note circulation	Current accounts
			short-term	long-term			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1938 December . .	21.7	—	—	0.6	1.2	22.0	2.6
1939 December . .	21.1	—	3.7	0.9	2.2	27.9	1.0
1940 June.	21.6	0.3	5.9	0.9	4.7	33.5	1.4
December . .	21.7	3.8	9.4	1.3	1.3	34.8	2.6
1941 March	21.7	5.6	10.7	1.2	0.7	37.9	2.1

* Government debt statistics on last day of month. Other figures from National Bank balance sheets on 25th of month up to June 1940; for December 1940 and March 1941 the combined returns of the National Bank and Bank of Issue for 2nd January and 27th March 1941.

(1) Including the so-called "valeurs-or" etc. On 25th June 1940 only B.fcs 155,000 and on 25th December 1940 B.fcs 8,190,000 of the total gold holding was in Belgium, the remainder being held abroad.

(2) Including for December 1940 and March 1941 two new items "Credits in foreign exchange" and "Foreign money and notes" and also the accounts of the Reichskreditkassen.

(3) & (4) Government debt held by the National Bank. Short-term: up to one year's maturity. The total outstanding, including the National Bank's holding on 31st March 1941 was B.fcs 18.6 milliard. Long-term: variations due chiefly to interventions on bond market. The December 1940 and March 1941 figures do not include the B.fcs 3,060 million transferred to the Bank of Issue on 3rd August 1940 as counterpart to the postal cheque accounts.

(5) Bills and advances grouped under this heading in the balance sheets of 25th June and December 1940 – for the two earlier balance sheets the same items have been taken less column (3), which may give an error of a few millions owing to the different dates of the returns.

(6) National Bank notes only – in addition Reichskreditkassenscheine were in circulation from May 1940 onwards.

(7) Including the Treasury deposit (of B.fcs 573 million in December 1938 but, for 1939 and 1940, not exceeding B.fcs 71 million).

May and June 1940 were the critical months and "credit to the private economy" probably reached its highest point about the end of June. In round figures, the huge increase of B.fcs 5.6 milliard in the note circulation in the first half of 1940 was due principally to B.fcs 2.2 milliard direct government borrowing and B.fcs 2.6 milliard other demands for credit (mostly by the banks). In the following months the tension was relaxed and, according to a statement of the Governor of the National Bank, the note circulation fell to B.fcs 30.99 milliard on 22nd August (i. e. by B.fcs 2.46 milliard in two months); but in the second six months of 1940 as a whole there was a net rise of over B.fcs 1 milliard in the note issue, accompanied by a further expansion of government borrowing from the National Bank by some B.fcs 4 milliard, while the "foreign exchange" holding of the two banks rose by B.fcs 3½ milliard. On 2nd January 1941 this item combines B.fcs 956 million "foreign credits", 1,915 million "foreign notes and coin" and 1,015 million on the two accounts of the Reichskreditkassen: the balance sheet of the Bank of Issue indicates that the foreign claims were predominantly in Reichsmarks (and doubtless represent, to a large extent, the withdrawal of Reichskreditkassenscheine and the accumulation of clearing claims). At the end of August 1940 the Ministry of Finance gave a guarantee of B.fcs 1 milliard to the Bank of Issue to cover possible losses due to the Bank's paying out amounts owing to Belgian exporters but remaining untransferred in Reichsmarks on the clearing account in Berlin. In the first three months of 1941 the expansion of the note issue was accelerated, rising by B.fcs 3.1 milliard compared with B.fcs 6.9 milliard during the whole year 1940.

The extension of official credit produced considerable liquidity in the economy of the country, and central-bank credit to the private economy declined rapidly from June 1940 to a very low level in 1941, while the commercial banks replenished their cash reserves. These conditions are also reflected in the returns of these banks.

Belgian Commercial Banks — some items from the quarterly returns*.

At end of month in millions of B.fcs.	Assets				Liabilities	
	Cash (1)	Bills (2)	Advances (3)	Government securities (4)	Deposits, current accounts etc. (5)	Special borrowing (6)
1939 December	1,546	2,754	4,829	3,089	12,685	721
1940 March	1,013	3,722	4,775	3,137	13,356	177
June	2,750	2,233	5,370	4,551	12,144	2,459
September	1,040	4,751	4,708	3,575	14,264	152
December	2,205	6,210	4,632	3,160	16,070	38
1941 March	1,681	8,962	4,491	3,092	18,075	144

* Excluding branches and agencies abroad or in the Belgian Congo.
(1) Including balance at National Bank, shown under "Current accounts" in the previous table.
(2) Including short-term government securities, there being some transfer in the last half of 1940 from the item given in column (4).
(3) i. e. "sundry debtors".
(5) 90 per cent. or more at sight or due within one month.
(6) Privileged or guaranteed creditors (e. g. the National Bank and the Rediscount Institute).

Deposits, after an increase at the beginning of the year, declined to their lowest at the end of June. The run on deposits was met and a high reserve of cash constituted by rediscounting bills (the bill holding falling by B.fcs 1.5 milliard, i. e. 40 per cent., in the three months) and by further borrowing of B.fcs 2½ milliard from official sources. The situation had entirely changed by September, and from June 1940 to March 1941 deposits expanded by nearly B.fcs 6 milliard, parallel to the Treasury-bill holding included in the bill portfolio. The discounting of commercial bills doubtless declined and advances to the public have been reduced from the expanded figures of June 1940. In the second half of 1940, there was also an appreciable increase in the volume of postal cheque accounts (about B.fcs 800 million) but savings-bank deposits have tended to decline (by slightly over B.fcs 1 milliard on the year).

Although the National Bank maintained its discount rate unaltered at 2 per cent. from 25th January 1940 (when it was reduced by ½ per cent.) conditions on the market changed fundamentally during the year, the confident tone of the early months being followed by extreme tightness and moratorium in the summer, while from August onwards increasing ease prevailed.

In the second half of the year measures were taken to extend the maturities of the short-term Treasury bills (4 and 8 months) forming part of the "Independence Loan" issued early in 1940, and in October a tax-exempt B.fcs 3 milliard 4 per cent. ten-year government consolidation loan was floated at 97½. In November 1940 the Bank of Issue announced that it would make advances up to 90 per cent. of the nominal amount of these bonds at 3 per cent. interest. Nevertheless, out of the total borrowings of B.fcs 12.7 milliard during the year B.fcs 11.3 milliard were at short-term (of which B.fcs 5.7 milliard were placed directly with the National Bank).

Belgian Government income from taxation and borrowing.

Quarterly in millions of B.fcs	Internal borrowing*			Taxation receipts	Total
	long and middle-term	short-term	total		
1940					
January–March . . .	+ 503	+ 1,804	+ 2,307	2,411	4,718
April–June	— 292	+ 3,212	+ 2,920	1,492	4,412
June–September . . .	— 1,000	+ 4,673	+ 3,673	1,604	5,277
October–December . .	+ 2,190	+ 1,607	+ 3,797	2,665	6,462
Totals	+ 1,401	+ 11,296	+ 12,697	8,172	20,869

* Change in nominal amounts outstanding according to the public debt return.

Taxation receipts, which fell heavily in the second and third quarters of the year but recovered to the normal figures in the fourth quarter, provided 40 per cent. of the government's income for the year as a whole. Estimates of budget expenditure have been raised from the B.fcs 13.8 milliard in 1940 (which was in fact greatly exceeded) to B.fcs 16.2 milliard in 1941 (excluding occupation costs).

The year 1940 in France may be roughly divided into three periods, the first extending to early May, the second to about the end of July and the third comprising the last five months of the year. These periods may be illustrated by the following figures:

Bank of France Return.

In milliards of Fr.fcs	1939	1940							
	28th Dec.	9th May	10th June	End July (5)	29th Aug.	26th Sept.	31st Oct.	28th Nov.	26th Dec.
Gold	97	85	85	85	85	85	85	85	85
Private credit (1) . . .	17	19	29	29	25	21	19	18	17
Public credit –									
old advances . . .	30	10	10	10	10	10	10	10	10
"war" advances (2) .	14	22	36	58	64	69	65	61	64
occupation costs .	—	—	—	—	27	39	57	64	72
Note circulation . . .	151	159	174	197	199	205	213	214	218
Current accounts –									
Treasury (3)	2	1	1	1	1	1	1	1	1
Private (4)	15	14	25	31	28	26	25	25	25
Reichskreditkassen .	—	—	—	—	27	35	39	39	41

(1) Bills discounted, 30-day and other advances and bills purchased on the market.
(2) Authorised by the decree of 1st September 1939 and by the Conventions of 29th February and 9th June 1940.
(3) Treasury and the Caisse Autonome d'Amortissement.
(4) Including other sight liabilities. (5) 1st August.

The first period was one of comparative calm. The expansion of Fr.fcs 8 milliard in the note circulation was due to the increase in "war" advances to the state. By the revaluation of the gold holding in February 1940, at the rate which had actually been in force since September 1939, it was possible, on the one hand, to wipe out Fr.fcs 20 milliard of the pre-war advances and, on the other, to transfer Fr.fcs 30 milliard of gold to the Exchange Stabilisation Fund, to serve for war purchases abroad. Hence the reduction of "old advances" by 20 milliard and the net decline of 12 milliard in the gold holding. The second period covers the phase of active campaigning and the disturbed period during the summer. In the month to 10th June there was an expansion of Fr.fcs 10 milliard in private credit and Fr.fcs 14 milliard for the government, accompanied by an increase of Fr.fcs 15 milliard in the note circulation. No weekly return was published from 10th June (the Bank having moved its head office from Paris to Saumur and from there to Bordeaux and Clermont-Ferrand during that month) but weekly figures from 1st August have been given in the Bank's annual report and more detailed explanations have been added by the Minister of Finance and the Governor of the Bank of France. At the General Meeting of the Bank in March 1941 the latter said that the bill portfolio, Fr.fcs 6 milliard on 9th May, reached its highest point of about Fr.fcs 18 milliard in the first days of July and that the total expansion of private credit in a few weeks amounted to Fr.fcs 14 milliard. The Bank of France made every effort to avoid a general moratorium. The banks were helped by a system of overdrafts against the deposit of Treasury bills (to eliminate continuous handling of securities) while commercial bills were discounted even if they carried the signature of debtors resident in occupied territory. To permit the Treasury to cover its immediate needs while tax collections were practically interrupted, the Treasury concluded an agreement with the Bank of France on 9th June 1940 by which the maximum of "war" advances was raised to Fr.fcs 70 milliard. This maximum was never exceeded despite heavy drawings in June and July. The effect of the demand on the Bank's credit was a rise in the note circulation to Fr.fcs 198 milliard early in August (an increase of nearly Fr.fcs 40 milliard, some 25 per cent. in three months).

The third period was characterised by efforts to put the internal financial position and the banking system in order and also by the appearance of a new factor: the payment of the costs of occupation fixed at Fr.fcs 400 million a day from 25th June.

Once the local financial administration could take up its work, collection of taxes began again. Deposits returned to the postal cheque accounts and the savings banks, and the net issues of Treasury bills rose to an average of Fr.fcs 6 milliard per month. Despite large exceptional expenditure the resort of the Treasury to the Bank of France to meet internal needs slowed down and later on ceased. At the same time the exceptional advances by the Bank to the market began to be reimbursed from the month of August, but at that time the first payments of occupation costs had to be met and the series of agreements between the Bank of France and the Treasury gave the latter special advances for that purpose. The first of these agreements was signed on 25th August and the amount of Fr.fcs 27.2 milliard, representing the amount of occupation costs for the period since 25th June, was debited to the account of new advances "for occupation costs" and a similar sum credited to the current account of the Reichskreditkassen. Altogether this account had been credited with Fr.fcs 77,144 million by the end of the year, Fr.fcs 72,317 million being debited to the special advances account and the balance temporarily to the government's "war" advances account. Of the total Fr.fcs 77 milliard odd, Fr.fcs 41,400 million (54 per cent.) remained unspent on the account of the Reichskreditkassen at the end of the year; Fr.fcs 24 milliard had been drawn to cover various payments while Fr.fcs 12 milliard was utilised to redeem Reichskreditkassenscheine previously issued by the occupying authorities (the amount remaining in circulation in France being unknown).

The "war" advances to the government at Fr.fcs 64 milliard on 26th December 1940, compared with Fr.fcs 36 milliard in June, had, in fact, fallen from their highest point of nearly Fr.fcs 70 milliard on 3rd October, and continued to fall to around Fr.fcs 60 milliard by the end of the year. The monthly revenue from taxation became more normal and the placing of Treasury bills easier. "The equilibrium of the Treasury would thus have been assured", said the Governor at the General Meeting, "if the charges which the Treasury had already assumed and which tended to diminish had not been increased in the last days of August by the payment of occupation costs." Central bank credit granted to the private economy of the country also decreased in the second half of the year to a figure slightly less than at the end of 1939, owing partly to the liquidity of the market and partly to the low level of business activity. As a consequence, the rise in the note circulation slowed down. After having reached nearly Fr.fcs 40 milliard in May, June and July, the increase rather exceeded Fr.fcs 20 milliard during the last five months of the year (taking the circulation to Fr.fcs 221 milliard on 2nd January 1941) and, according to a statement by the Minister of Finance, it was only Fr.fcs 11 milliard during the first four months of 1941, bringing the note circulation to Fr.fcs 232 milliard at the end of April.

With the armistice the great part of the military expenditure ceased: nevertheless, besides ordinary administrative expenses and debt service, there was considerable emergency expenditure on immediate reconstruction (bridges, etc.), on behalf of refugees and other relief in the face of the drying-up of ordinary income (although no tax returns were published, taxation revenue doubtless fell off in the spring and summer as in Belgium and Holland). The budget deficit, which towards the end of 1940 was estimated at about Fr.fcs 5 milliard a month, was largely met by the issue of Treasury bills, which explains the cessation of the Treasury's resort to the Bank of France except for payment of the occupation costs.

For 1941 a budget has been established which does not comprise the occupation costs (Fr.fcs 146 milliard covered solely by the Treasury) nor the expenditure of the Caisse Autonome d'Amortissement (Fr.fcs 9 milliard covered by the resources allocated to the "Caisse"). The budget estimates are as follows:

	Fr.fcs milliards
Ordinary expenditure	
Public debt	18.0
Annuities, pensions, etc.	14.5
Administrative expenditure	64.5
Total	97.0
Extraordinary expenditure	
Liquidation of expenditure resulting from the hostilities	29.0
Public works, etc.	8.6
Total	37.6

Ordinary receipts are estimated at Fr.fcs 68.2 milliard. They cover about two-thirds of ordinary expenditure (Fr.fcs 97.0 milliard) and nearly one-half of the total budget expenditure (Fr.fcs 134.6 milliard).

In his review of the budget estimates for 1941 the Minister of Finance said that even if the Treasury could obtain funds regularly at a moderate rate of interest, thanks to exchange control, rationing and other measures which limit the employment of available funds, it would be an exaggeration to think "that the increase in the public debt could be pursued indefinitely without danger".

The considerable issue of Treasury bills is reflected in the balance sheets of the three large banks (*Crédit Lyonnais, Société Générale and Comptoir National d'Escompte*).

France — Returns of three big commercial banks.

In milliards of Fr.fcs	Assets			Liabilities
	Cash	Bills	Advances and overdrafts	Deposits
1938 December	3.7	19.9	7.5	31.1
1939 March	3.5	22.2	6.8	32.2
June	3.4	23.4	6.7	33.5
September	5.0	19.3	7.7	32.2
December	4.5	27.2	7.9	39.4
1940 March	4.0	31.7	8.2	43.5
June*	.	.	.	.
September	5.8	36.7	9.7	52.1
December	6.2	43.8	8.4	58.5
1941 March	5.7	50.0	8.3	63.6

* Not published.

After considerable withdrawals in the second quarter of 1940 (reflected by the borrowing of the banks at the Bank of France) a reflux of deposits took place, at great intensity in the period from July to September (when stocks were largely sold out) according to the annual report of the Société Générale. The increase of deposits continued until the end of the year and into 1941. Although cash reserves were strengthened (partly owing, no doubt, to the prohibition of transfer from the occupied to the unoccupied area) and there was some private borrowing in the form of advances and overdrafts in the middle of 1940, the characteristic of the returns is the parallel rise of deposits and bills. As the circulation of commercial bills (and acceptances) has fallen with the decrease of business activity, the holding of Treasury bills must have risen by at least Fr.fcs 20 milliard during the year 1940 (an amount fully equal to the increase of deposits).

Two decrees of interest to the commercial banks were published early in November 1940, tending to lessen the government's calls on the central bank and to check the increase of the note issue. State contracts for works exceeding Fr.fcs 50,000 and for supplies exceeding Fr.fcs 200,000 may be settled by means of 6-month bills up to 50 per cent. of their value (hitherto government contracts had been paid in cash and only wartime requisitions with one-year Treasury bills). The recipient has the right to meet his own liabilities, to the same extent, by means of the bills received. The law also applies to the contracts and supplies of Départements, communes, public institutions and enterprises. The bills are drawn by the creditor upon the Crédit National and at the same discount rate as Treasury bills. Special arrangements have been made for the possible mobilisation of the bills during their period of currency at the Bank of France. Under the second decree, the payment of all amounts exceeding Fr.fcs 3,000 for such purposes as wages, salaries, rents, transport, services, supplies or works must be made by means of crossed cheques, bank transfers or transfers to a postal cheque account (or, for payments of the government, to an account opened at the Treasury office). All merchants on the commercial register are required to maintain a bank account or an account with the postal cheque office.

Although no recent statistics have been published, it is known that the fall of deposits at the savings banks was more persistent than at the commercial banks but that during the last months of the year new deposits again exceeded withdrawals. In January 1941 the Fr.fcs 20,000 deposit limit, which had been suspended in August 1940, was reimposed and the interest rate on deposits at the Caisse Nationale reduced from 2¾ per cent., at which it had stood for many years, to 2½ per cent. The rate for three-year National Defence bills was reduced from 4 to 3½ per cent. on 1st January 1941 and at the end of the month to 3¼ per cent.: in January also the rate on two-year Treasury bills was reduced from 3½ to 3¼ per cent., on one-year bills from 3 to 2¾ per cent. and on 6-month bills from 2½ to 2¼ per cent. The rate for Treasury bills of 75–105 days was maintained at 2 per cent., equal to bank rate.

In the middle of March 1941, the Bank of France reduced its bank rate and the rate for 30-day advances against government paper of not more than two years' maturity, from 2 to 1¾ per cent. This decrease of ¼ per cent. was followed by a similar reduction in the rates for National Defence Bills and for the various classes of Treasury bills. An improvement of 4½ per cent. government bonds to par in April 1941 opened up the possibility of a large conversion operation, covering some Fr.fcs 11½ milliard of public debt issued through the Crédit National.

The new Bank of Issue in the Governor-Generalship of Poland began its activities on 8th April 1940. New zloty notes were put out against the Reichskreditkassenscheine in circulation while notes of the Bank of Poland were also called in for exchange up to 31st May 1940. By a decree of the Governor-General the Bank of Issue was also authorised to mint coins and put them into circulation. As no statistics of any kind have been published, the present issue of notes and coin and the volume of bank deposits is unknown.

For the immediate re-establishment of the credit system after the German campaign in 1939, measures were taken locally by the heads of the civil administration. The records of the banks were put in order and as far as possible completed (a special difficulty arising from the fact that some of the assets had been removed abroad). The banks were reorganised, administrative changes made, expenses cut down and the granting of new credits made subject to official authorisation. In addition to the appointment of Polish trustees, German trustees were attached to the big state banks (the Postal Savings Bank, the National Economy Bank and the Agrarian Bank and later to the Polish Commercial Bank) to centralise responsibility and to reassure depositors. Two important banking measures were taken — the restriction on withdrawals of deposits and the separation of old and new business. In Warsaw, as a relief measure, a weekly maximum withdrawal of Zl. 100 from commercial banks and Zl. 50 from savings banks was allowed, beyond which limits permits were required for drawing on old balances. The weekly releases of deposits began with low percentages of balances as at 5th October 1939, and in some cases mounted up to 20 or 30 per cent. of the original balance (more where balances were very small). Outside Warsaw, payments out of old balances were generally determined by the amounts of receipts from old business.

In 1940 more uniformity was introduced throughout the country. By decree of 8th April, a Bank Control Office was set up under the German "Bank-dirigent" attached to the Bank of Issue. On 8th July 1940, the provisions regarding disposal of old balances in Warsaw were extended to the whole territory under the Governor-General and a sharper distinction made between old and new business. In particular, it was prescribed that new deposits might not be used for the discharge of obligations arising out of old business. No interest was allowed on old deposits but, as new business deposits and the bank investments grew, it became necessary to fix interest conditions. On 17th December 1940, by an order of the head of the Bank Control Office, the various kinds of new deposits were defined and interest rates fixed: sight funds received 1 per cent., deposits at notice 1½ to 3 per cent. and fixed deposits 1¼ to 2¾ per cent. (according to the period of notice required or the term of the deposit); savings deposits received 2–3 per cent. The rates for bank credit operations were not fixed. Branches or subsidiaries of three German banks have been opened in Cracow.

The ordinary budget for the first year of the Governor-Generalship showed revenue of Zl. 974 million and expenditure of Zl. 1,004 million, thus closing with the small deficit of Zl. 30 million. The extraordinary budget showed expenditure at Zl. 278 million.

In spite of great differences of economic structure, of monetary conditions and of political experiences in 1940, certain broad similarities in the developments may be perceived in the countries of south-eastern Europe. Generally these countries lack organised money and capital markets according to western standards, the rate of savings is low and the use of bank notes is more widespread than cheques and bank deposits. Unbalanced budgets, due largely to increased military and other extraordinary expenditure (such as the financing of clearing claims) has been covered from market borrowing only with difficulty, if at all. Recourse by the governments to central-bank credit has thus been frequent and, in some cases, on a considerable scale, with corresponding increases in the note circulation (and in bank reserves with the central bank). Owing to differences of accounting, it is not always easy to say exactly to what extent the recent expansions in note issues are due directly or indirectly to government borrowing from the central banks, but this is doubtless the predominant influence in most cases. In some instances withdrawals of deposits from the commercial and savings banks have led to considerable calls on the central banks for rediscounts and loans, but these phases have generally been temporary, continued government expenditure restoring liquidity to the economy. The following table gives the volume of note circulations since 1938, with 1929 and the subsequent lowest depression point to form a background against which the magnitude of the recent expansions may be judged.

South-Eastern Europe — Note circulations of central banks.

At end of year (or month) in millions of national currency units	Bulgaria	Greece	Hungary	Roumania	Slovakia	Yugoslavia
1929	3,609	5,193	501	21,144	—	5,818
lowest 1930–34 (1)	2,449	4,003	353	19,605	—	4,327
1938	2,800	7,239	863	34,902	—	6,921
1939	4,245	9,454	975	48,800	1,392	9,698
1940	6,518	15,369	1,387	64,349	1,657	13,834
March 1941	7,800	18,116 (2)	1,369 (3)	68,886	1,568	14,339 (2)
Percentage increase:						
in year 1940	54	63	42	32	19	43
in 2 years 1939–40	133	112	61	84	—	100
in 11 years 1929–40	81	196	177	204	—	138

(1) Lowest end-of-year figure, i.e. Roumania 1930, Greece 1931, Hungary 1932, Yugoslavia 1933 and Bulgaria 1934.
(2) Last return received: Greece, 15th March and Yugoslavia, 22nd March 1941.
(3) By the end of May 1941 the note issue had risen to Pengö 1,734 million, of which Pengö 491 million had been issued in incorporated territories in exchange for the notes of the former central banks: Pengö 85 million against Czecho-Slovakian crowns, 215 million against Roumanian lei and 191 million against Yugoslavian dinars.

In all these countries the note circulation in 1940 was well above the 1929 figure, generally two to three times higher (and three to four times greater than the depression lows). In all cases the expansion from the end of 1938 has been rapid, accelerating in 1940. Territorial changes have caused some duplications, e. g. the National Bank of Hungary, on 31st December 1940, had issued Pengö 171 million of its own notes against the equivalent of Roumanian notes withdrawn from incorporated territory (some Lei 5,120 million) which are also shown in the outstanding circulation of the National Bank of Roumania.

Although the rise of the note circulation in Bulgaria from 1929 to 1940 was less than in the other countries (the deflation in the early 'thirties going further), the increase in the last two years was the greatest. There were four well-defined phases in these two years, the relative stability in the first half of 1939 (around Levas 3 milliard), the expansion to 4½ milliard on the outbreak of war, followed by a reflux to about 4 milliard in the first eight months of 1940 and, finally, the rapid rise in the last four months of 1940 to over Levas 6½ milliard. The counterpart to the increase of the note issue from Levas 2.8 milliard to 6.5 milliard in the two years to December 1940 is not to be found, as in some other cases, in direct advances to the government. Nevertheless, official or semi-official transactions appear to be largely responsible for the expansion of central-bank credit. The bill portfolio increased by Levas 1.5 milliard, "securities" by 1.4 milliard and foreign exchange, not eligible as primary cover, by 1.1 milliard. These three items covered, besides some private demands, the following credit granted: a considerable amount for the financing of the Cereal Office (which has the monopoly of trade in many agricultural products); requirements due to the reincorporation of the South Dobrudja in the last part of 1940, including the issue of some Levas 200 million notes against Roumanian currency withdrawn; payments to Bulgarian exporters of sums remaining untransferred on clearing accounts with balances owing to Bulgaria; and, finally, Treasury bills purchased in connection with the application of the law of 9th March 1940, which authorised the Bank to invest up to Levas 2.4 milliard in Treasury bills previously delivered to foreign firms in payment of imports on government account. As considerable government purchases in Germany could not be financed by current budgetary means, a medium-term credit, up to seven years, had been arranged. But, since Bulgarian exports to Germany were paid in cash, the clearing with Germany became unbalanced and the National Bank thus acquired a large holding of Reichsmarks. The law of 9th March 1940 authorised the Bank to utilise its Reichsmark holding to repurchase the Bulgarian Treasury bills given in payment to German heavy industries. Eventually arrangements were made for the Bank to buy the bills at the moment of issue so that actually cash was paid to the foreign firms and the National Bank granted the credit to the government.

From September 1940, an effort was made to reduce interest rates, savings deposit rates being lowered from 4 to 3½ per cent. Bank rate was reduced, by two steps of ½ per cent. in October and December, to 5 per cent. accompanied by similar reductions, to 8 per cent., for the maximum legal rate (3 per cent. above bank rate) and thus for the commercial banks' advance rate also (a margin of 5 per cent. being required by these banks between lending and deposit rates).

Greece was the only country in south-eastern Europe engaged in active warfare in the year 1940, so that it is not surprising that the greatest demands were made on the central bank and that the note issue increased more on the year than in other countries shown in the table. Hostilities with Italy began on 28th October 1940, and it was in the last quarter of the year that 70 per cent. of the note expansion occurred.

On the outbreak of war there was a heavy call on bank deposits, the banks obtained advances of about Dr. 1 milliard from the Bank of Greece and a partial moratorium on the withdrawal of deposits was decreed (as well as certain relaxations as to payments of bills of exchange, protests, etc.). No monthly returns have been published by the commercial banks since the end of October but, judging by the balance sheets of the Bank of Greece, the pressure was relaxed early in 1941, the advances of the Bank, which had risen from Dr. 2½ to 3½ milliard, returning to their former level. Bank rate was maintained unchanged at 6 per cent. throughout and the restrictions on the withdrawal of bank deposits were relaxed in December and, on 11th February 1941, abolished. The net influence of private credit requirements was thus negligible and the whole expansion took place against the receipt of foreign exchange (British credits) for account of the government.

Bank of Greece.

At end of month In milliards of drachmae	Assets	Sight Liabilities		
	Foreign exchange holding	Note circulation	Sight accounts (1)	Total
1938 December	0.7	7.2	3.5	10.7
1939 December	0.7	9.5	2.5	12.0
1940 September	2.0	11.3	2.3	13.6
October	2.3	12.6	2.8	15.4
November	4.9	14.2	2.9	17.1
December	6.9	15.4	4.9	20.3
1941 January	7.2	16.2	5.2	21.6
February	13.8	17.0	8.0	25.0
March (2)	15.4	18.1	8.0	26.1

(1) Excluding the account of the International Financial Commission. (2) 15th March 1941.

The accounting of the foreign exchange credits caused some corresponding movements in the government's advances from the Bank which, however, cancelled out on balance. Part of the credits may have been utilised for purchases outside Greece, that shown in the return being apparently utilised as counterpart to drachma expenses of the Greek Government and of the British forces in Greece. No bank return has been received since 15th March 1941.

The similar development in Turkey may be mentioned here. The note circulation rose from £T 300 million to 420 million in 1940, the most important factor being £T 110 million advances to the government (since the beginning of August) accompanied, however, by similar contra gold entries on both the assets and the liabilities side of the balance sheet.

As a result of the Vienna Award at the end of August 1940 and the incorporation of Transylvania, the territory of Hungary was increased by over one-third and the population by one-quarter. In spite of the issue of Pengö 171 million notes in the new areas by the end of 1940, the increase in the note circulation was relatively less for the National Bank of Hungary in the two years 1939–40 than for other central banks shown in the table. If the Pengö 171 million be excluded, the increase was only 41 per cent. in the two years. The comparatively moderate call on central-bank credit in Hungary appears to be due, at least in part, to the more highly organised system of commercial banking in the country, to the great taxation efforts made and to stricter supervision of prices than in other south-eastern countries.

In November 1940, the Finance Minister stated that the original "investment" programme of 1938, involving the expenditure of one milliard pengö (of which 600 million was for armaments), had been expanded: to date 1,650 million had been spent (of which 570 million was received from taxes, 200 million from bank advances on future tax receipts and 880 million from loans) and the total expenditure envisaged had been raised to 2,800 million, including civil outlay in Transylvania.

The commercial and savings banks were called upon during the year to take up about Pengö 350 million government paper in various forms, to finance part of the direct taxes for the investment programme and to meet the increased demands for credit needed by industries busy with government orders as well as new credit demands for the recently incorporated territories. The credits thus granted were counterbalanced by an increase in deposits of about Pengö 300 million (almost entirely on current account and in the second half of the year) and assistance from the National Bank, whose bill portfolio expanded by Pengö 125 million. This expansion, together with a direct advance by the National Bank to the government of Pengö 100 million, practically accounts for the increase of Pengö 241 million which occurred in the note issue (apart from the Pengö 171 million exchange of lei notes).

Hungarian Commercial and Savings Banks Deposits.

At end of month In millions of pengö	Savings deposits	Current accounts	Total deposits
1937 December . .	1,053	771	1,824
1938 ,, . .	938	810	1,748
1939 ,, . .	1,012	952	1,964[1]
1940 March . . .	1,041	946	1,987
June	1,012	967	1,979
September .	1,040	1,028	2,068
December. .	1,135[2]	1,142	2,277

(1) Includes for the first time P. 43 million deposits from Upper Hungarian and Sub-Carpathian territories, incorporated in 1938 and 1939.
(2) Interest is added at the end of the year.

In October 1940, the National Bank decreased its discount rate from 4 to 3 per cent., followed by a similar decline of the commercial banks' lending rates (with a maximum of 6½ per cent.). Deposit rates were reduced by only ½ per cent. (to 2¼–3¼ per cent. for sight and 3–4 per cent. for time), further narrowing the margin between the banks' borrowing and lending rates. The first tranche of Pengö 100 million of the government 10-year "Transylvania loan" issued in January 1941 (for a total of Pengö 250 million) carried interest at 4½ per cent., compared with 5 per cent. on the earlier 30-year "Investment loans".

The greater part of the Lei 16 milliard increase in the note issue in Roumania in 1940 was due to the requirements of the government, although direct advances to the state remained unchanged on the year. A 50 per cent. revaluation of the gold holding in February 1940 gave a profit of Lei 10½ milliard, which went to the government, about one-half to repay previous credits and one-half to give new resources for military expenditure*. Further, the National Bank's bill holding increased steadily by Lei 3½ milliard from February to December 1940, although the rediscounts of the commercial banks fell on balance by Lei 1 milliard during the same period. Bank rate was reduced from 3½ per cent. to 3 per cent. on 12th September 1940 (with 2½ per cent. for

* From 1st April 1941 the gold holding was written down in price, giving a book loss of Lei 2,660 million.

agricultural bills and even 1½ per cent. in special cases, with the purpose of increasing Roumanian influence in economic enterprise). The territorial losses during the year caused the closing of 24 out of the Bank's 70 branches. Of the Lei 64.3 milliard notes shown as outstanding at the end of the year 1940, some Lei 5.1 milliard were held by the National Bank of Hungary and Lei 0.4 milliard by the National Bank of Bulgaria, having been exchanged for the notes of these banks. (A further unknown amount was circulating in Bessarabia, under the U. S. S. R.). No long-term government loans were floated during the year, the average yield of government securities rising from 7.9 per cent. in the first quarter of 1940 to 9.3 per cent. in December (after a peak of nearly 10 per cent. in October).

Clearing claims were shown in the balance sheet of the National Bank of Slovakia at Ks. 398 million at the end of 1940 against a debt of Ks. 3 million a year earlier, but a large part of these claims existed in the return previously in another form, such as the amounts due to the exchange of notes of the former National Bank of Czecho-Slovakia circulating in the territory before the new Bank was founded. (This item in the National Bank's return is only part of the total clearing debt owed to Slovakia, which reached Ks. 1,087 million at the end of 1940 and Ks. 1,402 in the middle of April 1941 — the German share being 589 and 963 million respectively. The rapid growth of the clearing "Spitzen" is a characteristic feature of Slovakian monetary developments). Bills discounted fell from Ks. 333 million to Ks. 257 million and loans against securities rose from Ks. 3 million to Ks. 260 million, showing a decline of credit for commercial uses accompanied by a demand for other purposes. The increase of Ks. 265 million in the note circulation on the year 1940 represents an expansion of less than 20 per cent. and is lower than for the other banks in the table.

As regards Yugoslavia, the direct advances of the National Bank to the government were clearly shown in the Bank's return as given on the next page.

Government borrowing at the National Bank of over Din. 8 milliard from the outbreak of the European war to 22nd March 1941 (the last weekly return to be published) provoked an increase of over Din. 7½ milliard in the note circulation and sight deposits at the Bank (while half a milliard of private credit was repaid). The note issue alone rose by 43 per cent. in 1940 and by 100 per cent. in the two years from December 1938. Savings deposits failed to increase: they fell to their lowest point in May–June 1940 and, although current accounts rose appreciably, the banks (still affected by the 1931 crisis) increased their cash reserves at the National Bank rather than their investments. The turnover of government securities declined by nearly 60 per cent. on the stock exchanges; the placing of long-term government securities was impossible and only the very shortest paper was taken by the banks. Although bank rate remained unchanged at 5 per cent., credit conditions were more accurately reflected by the market discount rate at 8½–9 per cent., while advances cost 10 per cent.: 4 per cent. was paid on savings accounts, while the average yield of government securities fluctuated between 6½ and 7½ per cent.

Yugoslavia — Note issue and related items.

At end of quarter in millions of dinars	National Bank					Other banks		
	Credit granted		Note circulation (3)	Sight deposits (4)	Total balance sheet (5)	Savings deposits (6)	Current accounts	
	to private economy (1)	to government (2)					post office (7)	fifty banks (8)
1938 December	1,771	—	6,921	2,093	9,731	11,478	1,710	1,268
1939 March	1,676	—	6,806	1,808	9,354	11,502	1,551	1,271
June	1,825	—	7,177	1,724	9,637	11,140	1,605	1,314
September	2,494	170	9,108	1,095	11,424	10,463	1,654	1,099
December	2,223	1,392	9,698	1,718	12,323	10,185	1,971	1,252
1940 March	1,815	2,755	10,400	1,874	13,196	10,245	2,294	1,364
June	1,901	4,626	12,210	1,862	14,913	9,784	2,697	1,289
September	1,632	5,994	12,403	2,464	15,672	10,251	2,846	1,710
December	1,787	7,780	13,834	3,531	18,121	10,543	3,344	1,754
1941 March*	1,990	8,338	14,339	3,476	19,867	.	.	.

* 22nd March 1941.

(1) Discounts and advances.

(2) New credits through direct advances and by rediscount of National Defence bills, largely through the intermediary of the State Mortgage Bank. In addition, there were old advances of Din. 2,220 million, which remained practically unchanged throughout the period under review. Total credit granted to the government, shown in the return at the end of 1940, thus amounted to Din. 9,000 million, the equivalent of nearly two-thirds of the note issue.

(4) Deposits of the state and private accounts.

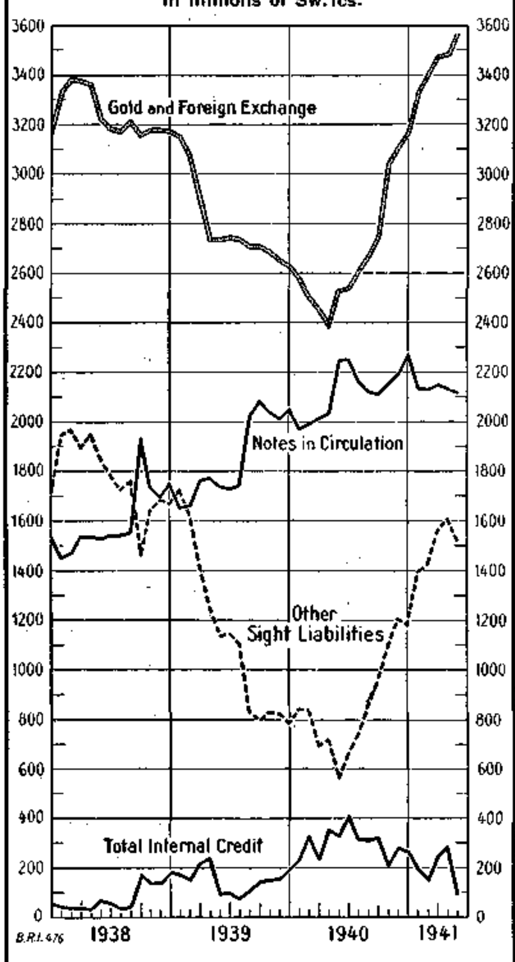
(6) All savings deposits in official and private banks and institutions.

(7) Cheque accounts at the Postal Savings banks.

(8) Current accounts at fifty reporting banks.

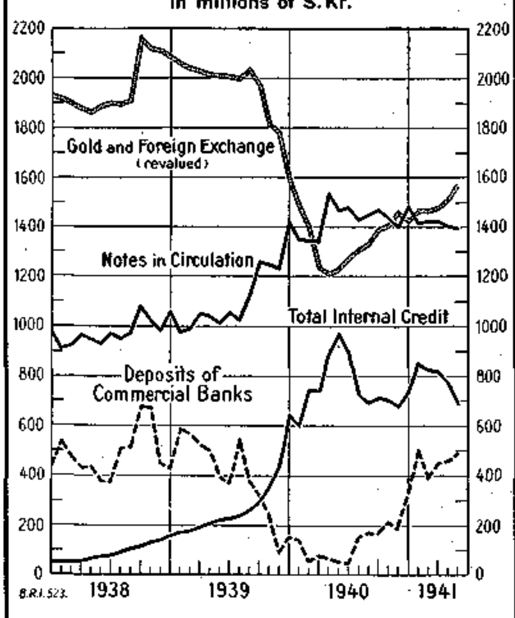
Sweden and Switzerland have much in common at the present time. Neutral in the war of 1914–18, the two countries, although not involved in the present war, have spent considerable sums upon defence. Both countries enjoy a similarly high national income and standard of living and have great financial strength. Both are cut off from their important overseas connections but have maintained their exchange rates, fixed on the dollar, and, in fact, experienced a considerable strengthening of their exchange positions in the latter half of 1940. Among the many differences may be mentioned the fact that, although Sweden has one and a half times the population of Switzerland (and over ten times the area), the Riksbank's reserve of gold and foreign exchange is under one-half of the Swiss National Bank's, the note circulation being also much lower. A good idea of the central-bank and market developments may be obtained from the graphs on the next page.

Both Sweden and Switzerland lost gold and foreign exchange almost continuously from 1938 until the spring of 1940, when the trend was reversed: the efflux was proportionately much more considerable for Sweden, especially from the outbreak of war, whereas the reflux to Switzerland was far greater. Internal credit conditions in Sweden were seriously affected at the time of the Finnish-Russian war and the Riksbank intervened to meet Treasury requirements (in particular for payments abroad) and to assist the commercial banks subjected to a rapid withdrawal of deposits. In Switzerland the cash reserves of the banks were large and borrowing at the National Bank was not considerable (although it must not be forgotten that the profits on gold revaluations of Sw.fcs 475 million were distributed between the Confederation and the Cantons in May 1940). In both countries the situation eased in the second half of the year, but the note circulation in Switzerland (of which perhaps Sw.fcs 400–500 million is hoarded abroad) continued to expand.

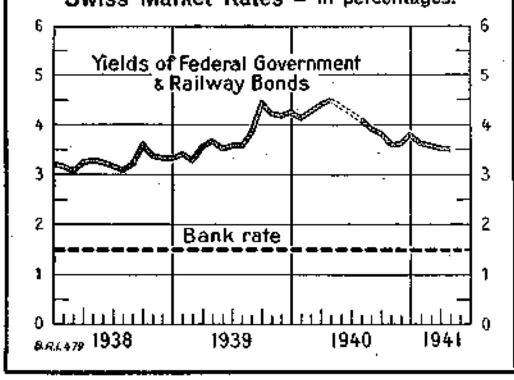


Swiss National Bank Return

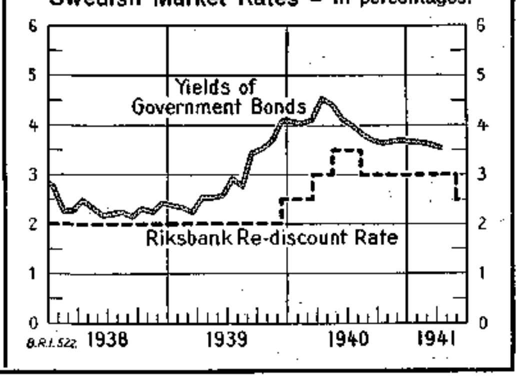
The greater pressure on internal credit conditions in Sweden is also shown by the rapid reaction of the Riksbank, which raised its rediscount rate three times by ½ per cent. to reach 3½ per cent. in the middle of May 1940 (two reductions of ½ per cent. bringing the rate back to 2½ per cent. at the end of May 1941). In Switzerland bank rate (which has a great influence



Sveriges Riksbank Return



Swiss Market Rates – in percentages.



Swedish Market Rates – in percentages.

on mortgage rates in the country) remained unchanged throughout the period at the very low level of 1½ per cent. The margin between short-term and long-term rates was much narrower in Sweden than in Switzerland: the yield on government securities, which in Sweden was barely over 2 per cent. until the spring of 1939, had risen to 4½ per cent. in April 1940; in Switzerland the rise in the yield was more moderate, from something over 3 per cent. to 4½ per cent. on 10th May 1940, when the stock exchanges were temporarily closed. In both cases the yields of long-term government securities fell below 4 per cent. before the end of the year.

Changing conditions on the money and capital markets naturally influenced the governments' borrowing policy to cover defence expenditure. In Sweden, where defence expenditure runs at about S.Kr. 1,800 million per annum, of which over one-half is to be covered by borrowing, issues of government bonds brought in S.Kr. 1,000 million during the year 1940, the most important being the 4 per cent. 5-year Defence bonds, of which S.Kr. 800 million were issued, while S.Kr. 340 million new Treasury bills were placed, largely with the banks. In Switzerland, where preparations for defence were started in the years before the war, current expenditure on defence works and mobilisation is at the yearly rate of nearly Sw.fcs 1,000 million, mostly met by loans: during the year Sw.fcs 350 million was obtained from 10-year bond issues (225 million at 3½–4 per cent. in March and 125 million at 3½ per cent. in November 1940), Sw.fcs 290 million from two issues of 3 to 4-year Treasury bills at $3^1/_8$–3¾ per cent., Sw.fcs 112 million from 3.6 per cent. tax certificates (to anticipate receipts from the national defence "sacrifice" levy), while Sw.fcs 250 million from the profits on the revaluation of the National Bank's gold holding in May 1940 were applied towards the amortisation of military expenditure.

As a contrast to these two countries (Switzerland and Sweden) may be mentioned Finland and Spain, both in the process of reconstruction in 1940 after a period of hostilities. A state of war existed between Finland and the U.S.S.R. from 30th November 1939 to 13th March 1940. Although it lasted only 3½ months, material losses, due to hostilities and to the terms of the Moscow peace treaty, were estimated at some 20 per cent. of Finland's national wealth. The losses could be divided into three main classes:

a) costs of mobilisation and carrying on the war,

b) material damage due to actual hostilities and

c) loss of property in the territory ceded under the terms of the peace treaty.

The meeting of the charges occasioned by damage and loss under b) and c) was to be effected by insurance and the issue of bonds in compensation. But as payments under the insurance scheme were to begin only in January 1941 and under the Indemnity Act in the following spring, the development of the financial situation in 1940 can be traced almost solely to the direct expenses of carrying on the war and of caring for refugees from the ceded territories.

Ordinary expenditure in the Finnish budget before the war was under FM 4,000 million and was well covered by taxation and other ordinary receipts. *Regular statistics have not been published since the autumn of 1939* but the Finance Minister in October 1940 put the total of the public debt at FM 17.5 milliard against FM 4.3 milliard at the end of October 1939, the increase of *FM 13.2 milliard giving some measure of the budget deficit during the year.* Part of the increase was due to foreign credits and the internal deficit was probably around FM 10 milliard, incurred mostly during the period of actual hostilities and covered by short-term borrowing. From the middle of December 1939 the regulations governing the Bank of Finland were relaxed to allow the government to borrow from the Bank against three-month Treasury bills which were placed in the bill portfolio (included under the item "Internal credit" in the following table).

Bank of Finland Return.

At end of month in millions of FM	Assets			Liabilities	
	Gold and foreign exchange	Internal credit	All other assets*	Note circulation	Other sight liabilities
1939 September	3,097	1,269	903	2,547	914
December	2,909	2,925	974	4,039	936
1940 March	1,781	5,544	969	4,743	1,646
June	1,689	5,511	1,226	4,647	1,869
September	1,853	5,506	1,549	5,090	1,886
December	1,790	5,396	2,307	5,551	1,935
1941 March	1,686	5,447	2,200	5,724	1,691

* *Including the item "Sundry accounts" as follows: September 1939: 201 million, December 1939: 228 million,* December 1940: 1,540 million and March 1941: 1,441 million.

At first there was considerable pressure on the banks, which by the end of 1939 had borrowed FM 740 million by loans and rediscounts from the central bank. Government spending and the reflux of deposits eased the position early in 1940 and by the end of the year less than FM 50 million of this debt remained. Thus the increase of the "Internal credit" granted by the Bank of Finland to FM 5.5 milliard in March 1940 and the freezing of the item at about this level is an indication of the government's direct borrowing from the central bank against Treasury bills on account of war financing. Emergency expenditure continued for immediate reconstruction purposes and on account of the refugees. Special borrowing by the government was put to an account included under the global item "Sundry accounts" in the Bank's balance sheet, which rose by FM 1,300 million in the year to 31st December 1940.

Other government paper was taken by the commercial banks and is *reflected in the rise of the internal credit items and the bond holding.*

The deposits and current accounts of the banks rose by nearly FM 3 milliard or 29 per cent. in the year to December 1940, FM 1 milliard going to increase the cash reserves (shown also in the "Other sight liabilities" of

Finnish Commercial Banks.

At end of month in millions of FM	Assets			Liabilities
	Cash	Internal credit	Bonds	Deposits and current accounts
1939 September	644	9,528	1,340	9,620
December	809	9,637	1,255	9,399
1940 March	1,212	9,905	1,242	10,399
June	1,218	10,676	1,611	11,541
September	1,099	11,233	1,509	11,704
December	1,854	11,021	1,655	12,150
1941 March	1,032	11,592	1,756	12,076

the Bank of Finland). Deposits with the savings banks, after some fluctuations, also increased on the year by FM 160 million to FM 8,140 million on 31st December 1940.

The Bank of Finland maintained its discount rate at 4 per cent. all through the period under review in spite of the tightness during the first weeks of the Russian war and the later period of liquidity. The increasing ease of the market facilitated the placing of a number of longer-term issues. At the end of October 1940 the issue of FM 1 milliard tax certificates bearing interest at 5 per cent. was announced. In January 1941 a four-year FM 1 milliard Reconstruction loan was issued, bearing interest on a sliding scale: 4 per cent. in the first year, rising each year by ½ per cent. to 5½ per cent. in the last year before maturity. This loan, the largest internal loan floated in Finland, was fully taken up by the middle of March and its subscription is reflected in the commercial bank returns at the end of March 1941. In April a Lottery loan for FM 200 million was floated and early in May 1941 a second FM 1 milliard Reconstruction loan.

The civil war in Spain lasted from July 1936 to March 1939. The publication of financial data was suspended but a statement of the budget position in the years 1936–39 was published by the Ministry of Finance in July 1940. Compared with a budget approximately in balance at Pesetas 4½ milliard in 1935, the revenue of the National government during the 2¾ years of war amounted to 3.7 milliard against expenditure of 11.9 milliard, giving an aggregate deficit of 8.3 milliard, of which 7.6 milliard was covered by borrowing from the Bank of Spain. No detailed accounts are available of the Republican budget finance, but Republican borrowing from the Bank of Spain over the same period amounted to Pesetas 23 milliard (including the credit given in return for taking over the fiduciary circulation of 25 and 50 peseta notes). The total borrowing of the two governments thus exceeded 30 milliard and would have raised the note circulation (and other sight liabilities) from 6½ milliard at the outbreak of war to some six times this level, if drastic measures had not been enforced. The amount of the note circulation and the current accounts at the Bank of Spain, as given by the National government after such measures had been taken, are shown in the following table.

Bank of Spain — sight liabilities.

In millions of pesetas	Note circulation[1]	"Free" current accounts[2]	Total sight liabilities
1936, 18th July	5,451	1,128	6,579
1939, 20th September[3] .	8,707	6,675	15,382
1940, 8th July[4]	9,278	3,182	12,460

(1) Excluding cancelled notes.
(2) Excluding blocked accounts and Treasury balance.
(3) Before the authorisation of 1st October 1940 for the Bank to intervene in the government bond market. (4) Estimate of Ministry of Finance.

The last advance from the Bank of Spain was taken by the National government in September 1939 and the table reflects only the advances obtained over the period by that government. Over Pesetas 13 milliard increase of note circulation on account of the Republican government was cancelled and 9 milliard of current accounts at the Bank of Spain, originating from the Republican advances, were made subject to an embargo and blocked. The value of the balances in "Madrid" pesetas has been fixed at various levels of depreciation, as the first step towards lifting the embargo on these accounts (as well as the blocked accounts in other credit institutions).

The *reduction in the sight liabilities of the Bank of Spain in the period* September 1939 to July 1940 was due to the floatation of two issues of medium-term Treasury bonds (in September 1939 and July 1940), yielding in all some 4¾ milliard, which was credited to the Treasury on its account at the Bank. The fact that the sight liabilities of the Bank of Spain are not reduced by the whole of this amount is largely due to the circumstance that deficits in the last quarter of 1939 were covered out of the account of the Treasury from the advance made by the Bank in September.

Budget expenditure for 1940 was fixed at 7.2 milliard, part of which was to be covered by borrowing. Revenue for the first half-year of 1940 amounted to 3.0 milliard, including, however, such items as the sale of stocks accumulated during the war. A special account was opened for budget arrears, including supplementary army estimates over and above appropriations in the budget, to be liquidated at whatever tempo circumstances permit. The application of an extraordinary budget necessary for reconstruction and other purposes has been postponed.

In order to regularise the market, a conversion operation was undertaken, fixing the rates for government funded debt at 4 per cent. and Treasury bonds at 3 per cent., higher rates being adjusted accordingly. Further, the Bank of Spain was authorised to buy and sell government securities on the stock exchange. On 1st March 1940 the official stock exchanges were opened and in the middle of 1940 the 4 per cent. internal perpetual debt was quoted at over 89 — higher than any annual average quotation since the debt was created in 1882.

With regard to the foreign position, the metallic reserves of the Bank of Spain, amounting to 2¼ milliard gold pesetas, appear to have been realised abroad by the Republican government. The National government, besides certain commercial credits, obtained supplies from Italy and Germany. The war debt to Italy was funded by an agreement of 8th May 1940 at Lit. 5 milliard, to be redeemed over a period of 25 years from 1942 in quotas increasing from Lit. 80 million to 300 million per annum and with interest payable from the middle of 1942 on a scale rising from ¼ to 4 per cent. In addition, Spain obtained a credit of Lit. 300 million from a syndicate of Italian banks, renewable half-yearly. German supplies were to a large extent compensated by exports of Spanish goods. The balance of debt is considerably smaller than that funded with Italy and is subject to negotiation. The total external debt of the National government is estimated at approximately 1¼ milliard gold pesetas.

The first steps to place public finances in Spain upon a sound basis involved the technical problem of fusing two monetary systems which, springing from a single system, became subject to different degrees of inflationary pressure. Much remains to be done to assist the reconstruction of private finances, including the completion of bank accounts where records have been removed, the recovery of securities and other documents, and compensation for the consequences of the removal of the embargo between credit, insurance and provident institutions.

The situation in Portugal contrasts strongly with that of Spain, and, indeed, with most European countries, since its position as a window on the Atlantic coast in 1940 gave it certain considerable advantages which, added to over ten years of prudent financial management, resulted in another budget surplus from current revenue. The only issue of internal public debt was to convert the outstanding foreign obligations into the home currency. A small floating debt is exceeded by about Esc. 1,000 million by government balances. The liquidity of the banks increased particularly in the second half of 1940, and two reductions of the Bank of Portugal's official discount rate by ¼ per cent., in February and March 1941, brought it down to 4 per cent. (from the level of 4½ per cent. which had been in force since May 1936).

Wars have always been waged with borrowed resources, but debts have so often been repudiated or currencies depreciated that few continuous records of comparable statistics are available. Thus the government debt in England, of which there is an unbroken record for over 250 years, is a unique example in this respect. It has, indeed, shown a series of sharp expansions and slower contractions corresponding to the alternating periods of war expenditure and peacetime retrenchment. After the Peace of Ryswick (1697) the total public debt was, for instance, gradually reduced from £21½ to £12½ million, but in consequence of the Seven Years War (1756–63), the American war (1775–84) and the French wars (1793–1815) it rose to £860 million. The hundred years of peace for England which followed (broken only by the minor Crimean and Boer wars) were a period of budget surpluses, permitting a reduction of the debt to £660 million, the amount outstanding at the beginning of the war of 1914–18. As a result of this war the internal debt rose rapidly and continued to rise to £6,600 million in 1923, while external debts were also incurred. Again followed a period of careful budgeting and debt repayment; the internal debt reached its lowest point in 1931 at £6,300 million; from then until 1938 there was an increase by £650 million, which, however, was almost wholly due to the issue of Treasury bills for the Exchange Equalisation Account, i. e. for acquisition of gold assets. Then a new period of armament expenditure began and since the war the internal debt has increased at an accelerating pace, amounting to £10,400 million on 31st March 1941. The following table shows the development of the budget and public debt quarterly over the last three financial years.

United Kingdom — Public Finances.

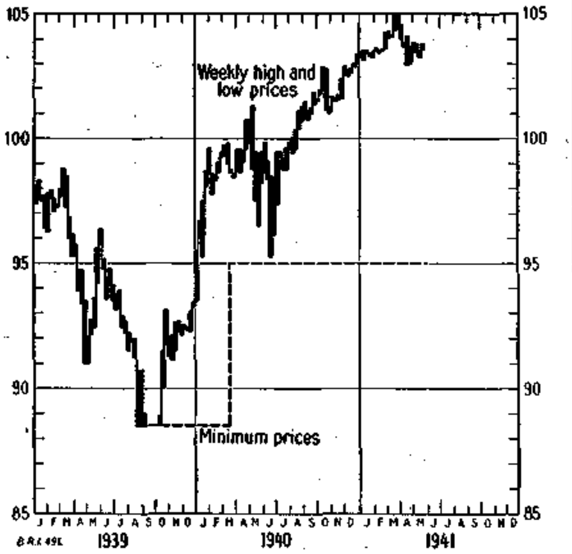
Quarterly in millions of £ sterling	Budget Accounts (cash basis)			Public debt increases or *decreases* (—) (1)			
	Taxation	Expenditure (2)	Deficit	Long and middle-term debt	Floating debt	Total	Other items (3)
1938 April–June . . .	132	235	103	13	93	106	(— *3*)
July –Sept. . .	174	238	64	64	(—*3*)	61	+ 3
Oct. –Dec. . . .	184	284	100	(— *1*)	104	103	(— *3*)
1939 Jan. –March . .	437	298	(+139)(4)	(—*17*)	(—*116*)	(—*133*)	(— *6*)
1939 April–June . . .	144	296	152	(— *2*)	156	154	(— *2*)
July –Sept. . .	194	347	153	(— *2*)	160	158	(— *5*)
Oct. –Dec. . . .	206	542	336	41	299	340	(— *4*)
1940 Jan. –March . .	505	625	120	163	(—*46*)	117	+ 3
1940 April–June . .	188	695	507	339	173	512	(— *5*)
July –Sept. . .	264	915	651	184	474	658	(— *7*)
Oct. –Dec. . . .	299	1,098	798	310	490	800	(— *2*)
1941 Jan. –March . .	656	1,159	503	326	192	518	(— *15*)
Financial years 1938–39	927	1,055	128	59	78	137	(— *9*)
1939–40	1,049	1,810	761	200	569	769	(— *8*)
1940–41	1,409	3,867	2,458	1,159	1,329	2,488	(— *30*)

(1) Nominal amounts. Movements as calculated from the annual national debt returns in March and from quarterly estimates. (2) Excluding sinking fund.
(3) Other items producing agreement between the quarterly deficit and nominal movements of public debt, e. g. sinking fund, movements of Treasury cash balance, difference between nominal amount of loans issued and cash receipts etc. (4) Surplus.

Revenue from taxation has risen particularly from the middle of 1940, owing to a larger yield of old taxes (notably income tax and certain consumption taxes) and the imposition of new ones (notably the excess profits duty, the national defence contributions and the purchase tax); and in the financial year 1940–41 it was one-third above the year 1939–40. But expenditure has risen more steeply as the war effort intensified and in 1940–41 was over double the previous year. The budget estimates for 1941–42 show still higher figures, revenue rising by nearly £380 million to a total of £1,786 million. The estimate of expenditure is put at £4,200 million but this figure excludes the value of supplies obtained in the United States. The Chancellor of the Exchequer explained that the figure comparable with the actual expenditure of £3,867 million in 1940–41 would be "far beyond" £5,000 million for 1941–42.

The first long-term borrowing for defence was the £80 million 3 per cent. National Defence loan 1954–58 issued in June 1938. In 1939 the government bond market was weak and the bulk of the deficit financing was made through an expansion of the Treasury-bill issue. The accompanying graph of quotations of 3½ per cent. War loan shows the recovery of the market from the latter part of 1939, the weakness of May and June 1940 (when the revised "minimum" price was nearly reached) and the subsequent rise to new high levels with returning confidence, when the opportunity was taken to float a number of long-term loans. The table on the following page shows the chief sources of borrowing in the last three financial years.

Gr. Britain – Quotation of 3½% War loan.



In the financial year 1939–40, 75 per cent. of the budget deficit was covered by short-term borrowing and in 1940–41 only 54 per cent. of a deficit more than three times as great. Long-term borrowing grew in importance as the war continued. A new issue of National savings certificates and a "savings campaign" produced an increase of Savings certificates at the rate of over £14 million a month during the fiscal year 1940–41; 3 per cent. Defence bonds were placed "on tap" in November 1939 and the issue continued throughout the period; a 3 per cent. War loan for £300 million was floated in March 1940; 2½ per cent. National War bonds were placed "on tap" in June 1940 and produced £440 million during the year, a further issue being made in January 1941, while £38 million was subscribed between March 1940 and March 1941 as loans without interest. Nearly £250 million out of a total of £350 million maturing 4½ per cent. Conversion loan was converted to a 2 per cent. basis (and the balance repaid in cash). In the financial year 1940–41 as a whole nearly £1,200 million new money was raised at long term, compared with £200 million in 1939–40.

The balance of the budget deficit, some £1,300 million, was covered by an increase in the floating debt by this amount to £2,800 million on 31st March 1941. The Treasury bill issue increased by £780 million to £2,210 million on 31st March 1941, having doubled since the beginning of the war. Although the importance of the division of Treasury bills into those sold by "tender" (to the market) and those "on tap" (to official and semi-official investors) has diminished, it is not without significance that tap bills have increased by £760 million on the year to March 1941 compared with a rise of only £110 million

United Kingdom – National debt (nominal amounts)
Quarterly increases or *decreases* (—).

Quarterly in millions of £ sterling	Long-term borrowing					Floating debt				Total long-term and floating debt
	Savings issues (1)	Market issues (2)	"Other debt" (3)	Total (4)	Adjusted total (5)	Treasury bills (6)	Ways and Means advances (7)	Treasury deposits (8)	Total (9)	(10)
1938 April–June	*(– 1)*	14	—	13	13	22	71	—	93	106
July–Sept..	*(– 2)*	66	—	64	64	32	*(–35)*	—	*(– 4)*	61
Oct.–Dec..	*(– 1)*	—	—	*(– 1)*	*(– 1)*	102	2	—	104	103
1939 Jan.–March	—	—	—	—	*(–17)*	*(–93)*	*(–23)*	—	*(–116)*	*(–133)*
1939 April–June	*(– 2)*	—	—	*(– 2)*	*(– 2)*	101	55	—	156	154
July–Sept..	*(– 2)*	—	—	*(– 2)*	*(– 2)*	194	*(–34)*	—	160	158
Oct.–Dec..	41	—	—	41	41	283	16	—	299	340
1940 Jan.–March	72	99	2	173	163	*(–42)*	*(– 4)*	—	*(– 46)*	117
1940 April–June	88	244	5	337	339	198	*(–25)*	—	173	512
July–Sept..	87	184	15	286	184	295	55	124	474	658
Oct.–Dec..	90	212	8	310	310	231	45	214	490	800
1941 Jan.–March	184	230	8	422	326	65	36	91	192	518
Financial years										
1938–39	*(– 4)*	80	—	76	59	63	15	—	78	137
1939–40	109	99	2	210	200	535	34	—	569	769
1940–41	449	870	36	1,355	1,159	789	111	429	1,329	2,488

(1) Under this heading are included issues made directly to absorb savings:
a) National savings certificates on tap to small savers. New issues were made from November 1939 onwards. The total outstanding at the end of March 1941 (with a small amount of National savings bonds) was £ 605 million, excluding accrued interest.
b) 3 per cent. seven-year Defence bonds placed on tap at par in November 1939, of which £ 249 million were issued by the end of March 1941.
c) 3 per cent. Savings bonds 1955-65 on tap at par from 2nd January 1941, of which £ 89 million were issued by the end of March 1941.

(2) "Market" issues are, in general, the war loans floated publicly on the open market and quoted on the stock exchange. They may be taken up by savings banks, life assurance companies and similar bodies and thus cover the indirect investment of small savings. The loans under this heading are:
a) £ 80 million 3 per cent. National Defence loan 1954-58 issued at 98 in June 1938. A further £ 76 million tranche of this loan was issued in the January-March quarter of 1941 directly to the National Debt Commissioners, as an investment for savings-bank funds.
b) £ 300 million 3 per cent. War loan 1955-59 issued at par in March 1940.
c) $2\frac{1}{2}$ per cent. National War bonds 1945-47 placed on tap at par from June to 31st December 1940 and $2\frac{1}{2}$ per cent. National War bonds 1946-48 on tap at par from 2nd January 1941. At the end of March 1941 £ 593 million had been subscribed to these two issues.

(3) The item "Other debt" in the national debt return covers in particular voluntary loans made without interest for the duration of the war.

(5) Net total including other long-term debt movements. The difference of about £ 200 million between columns (4) and (5) in the financial year 1940-41 is explained by two debt redemptions. In the July-September quarter of 1940 the maturity of £ 350 million $4\frac{1}{2}$ per cent. Conversion loan was met as to £ 248 million by conversion into 2 per cent. Conversion loan 1943-45. In January-March 1941 £ 100 million 1 per cent. Treasury bonds were redeemed.

(6) Three-month Treasury bills.

(7) Ways and Means advances from the Bank of England and from government departments with surplus balances.

(8) Six-month deposits made by commercial banks with Treasury at $1\frac{1}{8}$ per cent. in units of £ 500,000. The receipts given are non-negotiable but carry right to repayment before maturity under rebate at bank rate.

(10) Corresponds to total borrowing in previous table.

in the bills issued by tender. Some of these tap bills were probably held by the Unemployment Fund, by government insurance schemes and similar bodies but, in so far as they are held by government offices as an employment for surplus balances, the debt is due by one government department (the Treasury) to another and not to the public. Tap bills have also been issued to the Exchange Equalisation Account against the disposal of the gold held by the Account for foreign payments. In this way the budget deficit has been covered by the utilisation of existing monetary reserves. The case is somewhat different with regard to mobilised dollar securities; here a reserve of the country as a whole has been used, not a reserve belonging to the government itself. The dollar securities were bought by the government from the original owners for cash (sterling), the government raising the money by increasing its borrowing. Doubtless one reason for the large increase of long-term lending to the government in 1940–41 was the fact that previous owners of dollar securities mobilised during the year reinvested the proceeds, directly or indirectly, in U. K. government (sterling) securities. The Chancellor of the Exchequer, in his budget speech in April 1941, said that, in round figures, government expenditure in the first 18 months of war was £4,650 million, of which £2,000 million was met by taxation, £1,000 million from overseas resources and the balance of £1,650 million by borrowing.

An interesting innovation in 1940 was the invitation to the banks to make direct six-month deposits with the Treasury. £430 million deposits bearing interest at $1^{1}/_{8}$ per cent. were outstanding at the end of March 1941. The financing of the budget deficit was the outstanding influence on the banking system during the year, as the following table shows:

London clearing banks' returns.

In millions of £ sterling	Assets					Liabilities
	Cash reserves and money at call	Bills discounted	Treasury deposit receipts	Invest-ments	Advances	Deposits
1938 December [1]	409	233	—	625	979	2,271
1939 September	413	236	—	603	1,011	2,278
December [1]	444	334	—	609	1,002	2,441
1940 March	390	336	—	611	1,006	2,363
June	436	384	—	636	962	2,469
September	432	401	91	697	937	2,597
December [1]	483	265	313	771	906	2,800
1941 March	420	194	374 [2]	821	908	2,764

(1) December figures are given for the 31st of the month. Other returns are on varying dates in the month.
(2) Part of the total of £ 430 million outstanding at the end of March 1941 was held by other than clearing banks.

On the year to December 1940 deposits have risen by £359 million, that is by 15 per cent., part of which, however, is due to the longer time taken for the collection of cheques, owing to the physical inconvenience under which the London market operated, particularly in the second half of the year. Bank credit granted to private, industrial and commercial customers decreased: advances fell by £96 million while the number of commercial bills discounted doubtless declined (over nine-tenths of the bills in circulation being Treasury bills). More bank credit has been granted to government contractors but less in other directions, particularly for the financing of foreign trade, now largely in government hands. Credit granted directly or indirectly to the government grew considerably. Treasury deposit receipts and bills discounted (including Treasury bills) together were £244 million higher on the year, while "investments" (including government securities) rose by £62 million. These figures should be related to the increase, in 1940, of £1,091 million in the floating debt and £996 million in the long-term government debt. The clearing banks appear to have taken rather over £300 million of government issues exceeding £2,000 million, say 15 per cent.

The expansion of clearing-bank deposits in 1940 was accompanied by a rise of the banks' cash reserves at the Bank of England by £20 million to £136 million. The Bank of England's return was also affected by the increase of the note circulation by £60 million to nearly £620 million, almost the whole increase taking place in the first seven months of the year.

Money market conditions have continued very easy. Bank rate, which was raised for a few weeks on the outbreak of war, has remained since 26th October 1939 at 2 per cent., while the discount rate on Treasury bills, which dominates the market, was steady in 1940 at a shade over 1 per cent., falling in March 1941 to under 1 per cent. for the first time during the war. While the weight of money does not find an expression in the Treasury-bill rate, which, for technical reasons, is stereotyped, it affects the volume of applications, which has been as high as £160 million for £65 million bills offered by tender. Long-term rates are best expressed by the yield of representative government securities. The quotation of the 3½ per cent. War loan (a funded issue redeemable at the option of the Treasury only after 1952), which was 95 at the beginning of the year, giving a flat yield of 3.7 per cent., rose above par in April and, after a setback in June, gradually strengthened to 105 in March 1941, with a flat yield of 3.3 per cent. Shorter-term issues and loans with fixed maturity dates gave lower yields and 2½ per cent. National War bonds of 5–7 years, for example, have been on tap at par since June 1940. In February 1941 the legal maximum at which the government might borrow money was lowered from 5 to 3 per cent., a measure taken in order to indicate that the authorities were determined to borrow at low rates all through the war.

With the government monopolising the market, capital issues for others have been very small, as the following table from the London "Economist" shows.

England — Capital issues [1]

In millions of £ sterling	Government	All other domestic borrowers	Empire [2] and foreign	Total
1937	143	244	71	458
1938	76	138	59	273
1939	37	78	28	143
1940	1,071 [3]	17	1	1,089

(1) Including placing on the stock exchange as given by "permission to deal".
(2) Of the total of £159 million over the four years, £144 million was on Empire account and only £15 million foreign.
(3) Market issues only. The total thus excludes such government borrowing as National savings certificates, Savings bonds and loans without interest given in previous tables.

There were no refunding issues during the year except for the government issue to convert £350 million 4½ per cent. Conversion loan to a 2 per cent. basis, already mentioned. In March 1941 the Treasury lifted the ban on municipal conversions for issues bearing interest at more than 4 per cent., of which about £30 million were outstanding.

For the British Empire the cost of the war may be traced in swollen budgets and public war loans, and in the position of the banks. In Canada the budget, which generally balances around $500 million, closed for the year ended March 1940 with expenditure of $680 million and a deficit of $120 million due to war expenditure. The first nine months of the 1940–41 financial year (to 31st December 1940) had expenditure at $800 million, of which $480 million was directly due to the war, and showed a deficit of $220 million. War expenditure expanded from $40 million a month in June and July to $85 million in December 1940 and for 1941–42 was estimated at over $100 million monthly. Increase of taxes has taken place and the Rowell-Sirois report recommended a unification of taxation, particularly the levying of income tax by the Dominion alone, the provincial governments withdrawing from this sphere.

In October 1939 the government sold $200 million 2 per cent. two-year Notes to the banks, but in 1940 efforts were made to reach the investing public and two public war loans were floated, in February 3¼ per cent. bonds at par and in October 3 per cent. bonds at 98¾, both issues for twelve years and producing together $500 million new money. War savings certificates were sold from May 1940 onwards and $29 million was subscribed by the end of the year.

There was a considerable extension of the note issue of the Bank of Canada, which rose from $230 million to $360 million during the year, one-half of the increase taking place in May, June and July 1940. The Bank purchased securities to prevent the increase in active circulation from reducing the cash reserves of the chartered banks, the deposits of which fell on balance by $100 million to $3,280 million during the year, parallel to the reduction of their security holding. Bank loans to industry did not show the expected expansion in spite of the defence activity, what increase there was being mainly due to agricultural borrowing in connection with the large wheat carry-over. Bank rate remained unchanged at 2½ per cent. throughout the year and the average rate for three-month Treasury bills was 0.7 per cent., while the yields of government bonds, which had risen somewhat in the middle of the year, declined to a fraction over 3 per cent.

In South Africa and India the position is notable for its external strength. The Reserve Bank of South Africa increased its gold holding from £30 to 43 million (gold pounds) during the year, there being a moderate expansion of the note issue from £SA 21 to 24 million, while the commercial banks' cash reserves rose from £SA 25 to 45 million. On this cash basis deposits with the commercial banks were expanded from £SA 100 to 125 million. Up to the financial year 1938–39 (ending March) the South African budget with revenue around £SA 50 million gave a moderate surplus and in spite of defence expenditure in 1939–40 only £SA 2 million had to be raised by loans. There was a great expansion of defence expenditure from the middle of 1940: two supplementary budgets introduced in August 1940 and January 1941 raised the original figure of £SA 14 million for defence expenditure to £SA 60 million. Although there were certain increases of taxation, the greater part of this sum was to be covered by loans. £SA 18 million was raised from the public by two loans in October 1940, 3½ per cent. 12 to 14-year bonds at 99½ and a 2½ per cent. 6-year issue at 99. In addition, £SA 14 million was received from the Public Debt Commissioners out of a special issue.

In the year to December 1940 the sterling assets of the Reserve Bank of India rose from £85 million to £141 million. The note circulation remained stable, but the reserve balances of the scheduled banks more than doubled from 172 to 479 million rupees. The deposits with the scheduled banks in India rose from 2,480 to 2,760 million rupees, while their advances declined from 1,340 to 1,000 million, showing the extreme liquidity of the market. In these conditions further considerable progress was made towards repatriating India's sterling indebtedness. Defence expenditure was on a comparatively small scale until the introduction of a supplementary financial bill in November 1940, and the subscription of 306 million rupees (equivalent to £23 million) to Indian defence bonds.

Defence expenditure in Australia, which was £A 55 million in the financial year 1939–40 (ending June), was increased by the supplementary budget of November 1940 to £A 186 million (of which £A 143 million was to be spent in Australia and £A 43 million abroad). Three war loans were issued in 1940: in February 3⅜ per cent. was paid on five-year and 3⅝ per cent. on 10 to 16-year bonds, while the issues in May and December were at 2¾ per cent. for middle-term and 3¼ per cent. for long-term bonds; the three issues produced £A 66 million. In addition, £A 17 million was raised from war savings certificates and £A 5 million by interest-free loans. The banking system is very liquid, partly because the trading banks transferred London funds to the Commonwealth Bank in exchange for Australian resources; whereas current accounts at the trading banks remained stable at a little over £A 200 million during the year, savings accounts rose from £A 132 to 155 million; on the other hand, their advances declined, largely owing to the financing of the export of primary products directly by the government. In New Zealand the precedent of the last war was followed, when a compulsory loan to produce £NZ 8 million was announced in September 1940: contributions are to equal the amount of income tax paid in 1938–39 in excess of £NZ 50 for individuals and £NZ 70 in the case of companies. The loan bears no interest before October 1943 and thereafter 2½ per cent. will be paid until 1953, when the loan is repayable. In addition to expenditure voted for "defence" in the overseas territories of the British Empire, contributions to the war took the form of increased shipments of foodstuffs and raw materials to the main theatres of war, paid for by funds of the mother country.

As regards other overseas countries, interest naturally centres on the United States, the whole economy of this vast area having, in recent months, come more and more under the influence of preparations for defence. The momentum of developments may be gauged from the budgetary expenditure for this purpose: the slow rise of defence outlay up to June 1940 changed to a sharp acceleration and in the last three months of 1940 it was nearly double the preceding quarter.

United States — Treasury accounts.

Quarterly in millions of dollars	Expenditure					Revenue	Excess of expenditure	Taxation receipts as percentage of total expenditure
	National defence	Agricultural aid	Unemployment relief (1)	Interest on debt	Total (2)			
1939 January–March	285	208	680	167	2,088	1,326	762	63.5
April–June	303	276	643	349	2,320	1,116	1,204	48.1
July–September	331	169	497	185	2,279	1,313	966	57.6
October–December	358	317	454	270	2,201	1,164	1,037	52.9
1940 January–March	403	352	475	202	2,202	1,558	644	70.8
April–June	466	183	493	384	2,316	1,353	963	58.4
July–September	596	205	432	188	2,283	1,489	794	65.2
October–December	1,136	321	438	303	2,858	1,436	1,422	50.2
1941 January–March	1,909	301	443	196	3,585	2,447	1,138	68.3
Calendar year 1939	1,277	970	1,831	971	8,888	4,919	3,969	55.3
1940	2,601	1,061	1,501	1,077	9,659	5,836	3,823	60.4

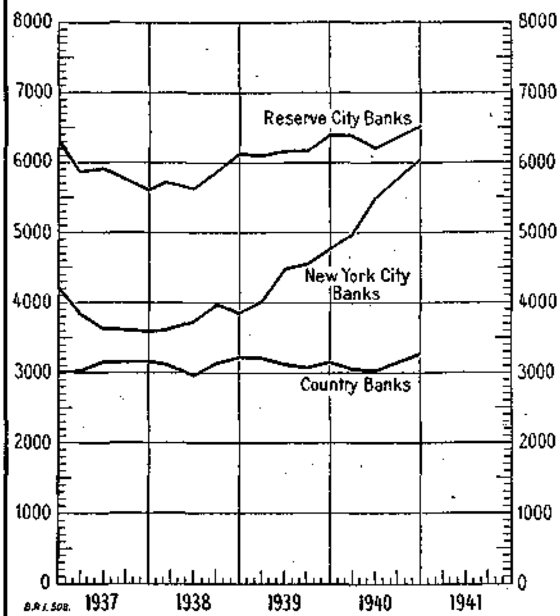
(1) Owing to changes in the Treasury statement the first two quarters of 1939 are not exactly comparable with later figures.
(2) Excluding debt retirements but including other expenditure as well as that classified above. The third quarter of 1939 also includes \$120 million paid to Commodity Credit Corporation for restoration of capital impairment; in last quarter of 1940 a deduction of \$203 million is made on account of a repayment of surplus capital funds by farm credit agencies.

Defence expenditure reached nearly \$1,600 million in the financial year 1940 (ending June): a figure of \$6,500 million is envisaged for 1941 and a still higher amount for 1942, when it is estimated to be over 60 per cent. of total budgetary expenditure against under 20 per cent. in 1940. The figures in the table give actual expenditure: commitments are much higher. From June 1940, when the national defence programme was inaugurated, to 15th March 1941 total authorisations of expenditure for the defence programme reached \$30,000 million (including \$7,000 million to finance the Lend-Lease Act), while a further \$9,000 million had been recommended and was before Congress for authorisation. Not the whole of the \$39,000 million is for the manufacture of war material; included in the total is the cost of upkeep of the army and navy, the building of barracks and factories, etc. British orders in the United States totalled \$3,500 million, part of which might be covered by the Lend-Lease Act. For the financial year 1941–42 total anticipated budget expenditure is placed at \$19,000 million, of which \$9,200 million is expected to be covered by the yield of present taxation, while a further \$3,500 million is to be raised by new taxes (so that two-thirds of total expenditure would be covered by ordinary revenue).

In 1940 the gross Federal debt grew by rather over $3,000 million and at the end of 1940 slightly exceeded $45,000 million, the previous legal limit. But the first Revenue Act of 1940 permitted the issue of $4,000 million for national defence outside this limit and a beginning of such issues was made during the year. In February 1941 the total authorised issue of government obligations was raised from $49,000 to $65,000 million and the way thus prepared for the financing of the extraordinary appropriations for defence. Of the increase in the government debt in 1940 two-thirds took place in the second half of the year.

In fact, the year may be divided into two parts. In the first half-year the budget deficit was lower than in 1939 and was more than covered by special issues to absorb excess receipts of the various government agencies and trust funds and by issues of U. S. savings bonds, so that a net amount of some $300 million of market issues was repaid: gold imports were large (and continued so until the autumn) but the government bond market nevertheless had times of weakness, particularly in May and June. Conditions were reversed in the second half of the year, especially in the latter months: from July to December 1940 $1,200 million net market issues were made to cover the increasing deficit, while bank purchases, effected in spite of a declining gold influx, led to a fall in yields. The division of the year into two contrasting parts is also shown by the index of industrial production, which fell until July, from which point it rose rapidly as armaments production developed.

Member Bank Holdings of U. S. Government Obligations.
Quarterly, in millions of dollars.



It is noteworthy that the New York City banks accelerated their purchases of government bonds in 1940, buying $1,300 million, an amount exceeding their acquisitions in the two preceding years. All other member banks in the United States bought less than $1,000 million in the three years, the country banks' holdings remaining practically unchanged within a narrow range. The essential difference between the New York banks and other member banks is that in New York 93 per cent. of deposits are on demand and the banks' principal assets are reserve balances and U. S. Government securities, whereas the other member banks have only 63 per cent. of their deposits on demand and their principal assets are commercial and other loans.

U.S. member banks – commercial loans*.

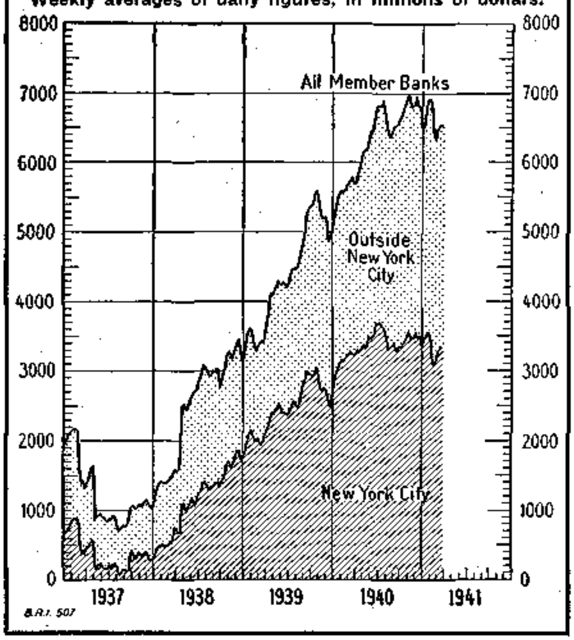
At end of month in millions of dollars	All member banks	Weekly reporting member banks
1939 December	6,116	4,400
1940 June.	6,274	4,399
September	.	4,575
December	7,069	5,018
1941 March	.	5,420

* Commercial, industrial and agricultural loans.

An interesting movement since the putting into force of the defence programme has been the revival of commercial loans. Figures are available for all member banks only on the call dates but the statistics of the weekly reporting banks clearly show the continuation of the sharp expansion since June 1940. The level early in 1941 passed the peak of 1937. In June 1940 the Reconstruction Finance Corporation was authorised to make loans to private corporations for defence purposes; up to the end of the year $7 million of such loans had been granted while commitments aggregated some $100 million.

Although the money market remained very liquid throughout 1940, it is not without significance that excess reserves ceased to grow, for reasons which are not purely accidental and temporary. Broadly speaking, the purchase of gold by the Treasury, through the issue of gold certificates, leads to increases in the deposits and reserve balances of the member banks by the same amounts except in so far as these certificates or other money go into circulation. Since only a percentage of the deposits is necessary as reserves, the excess of reserves above legal requirements has tended to grow cumulatively with the gold influx in recent years. But member-bank deposits rise also with the extension of credit through loans or the purchase of securities, and reserves are of course "required" against these deposits also.

Excess Reserves of U. S. Member Banks.
Weekly averages of daily figures, in millions of dollars.



Although the gold stock increased by a record $4,350 million in 1940, the inflow decreased from the exceptional $1,500 million in the second quarter to $750 million in the last quarter (and is only $350 million in the first three months of 1941). As the gold influx trailed off in the second half of 1940 (and Federal Reserve credit was reduced), the note circulation rose and the increase of the total of member-bank reserve balances was very small. Deposits with the member banks, however, continued their rapid expansion (the extension of credit against loans and investments being considerable), causing a proportionate increase in the "required" reserves and cutting down the excess over requirements. Although the New York banks hold one-half of the excess reserves, they have large balances due to other banks and thus hold proportionately less of the total idle funds than appears from the graph.

The jump of deposits with all member banks by $6,000 million in 1940 raises total deposits to the record of $46,000 million — double the figure of June 1933 and over one-third higher than in 1929. The increase of money in circulation by over $1,100 million in 1940 brought the total at the end of the year to $8,700 million against $4,500 million in 1929. If, under the influence of the defence programme, bank deposits and the note circulation continue to increase as the gold influx declines, excess reserves will be further compressed. But excess reserves are still very high and the market extremely liquid so that there is as yet little check on the expansion of credit and, indeed, only limited possibilities of control by the Federal Reserve Banks.

In these circumstances the Board of Governors of the Federal Reserve System, the Presidents of the Federal Reserve Banks and the Federal Advisory Council presented a special joint report to Congress at the end of 1940, for the first time since the creation of the Federal Reserve System. After reviewing the situation of the circulation, bank deposits and excess reserves, and stating that the Federal Reserve System found itself "in the position of being unable effectively to discharge all of its responsibilities", it was specifically recommended that an increase be made in the legal reserve requirements (thus increasing the "required" reserves and automatically decreasing the excess reserves) and that within certain limits the Federal Open Market Committee be authorised to change these requirements (which should apply to all banks in the country, not only the member banks as at present) from time to time. Other measures were also mentioned as desirable, including the "insulation" or sterilisation of further gold imports.

In this special report the leading authorities of the Federal Reserve System said that interest rates had fallen to unprecedentedly low levels and that some were "well below the reasonable requirements of an easy-money policy ...". Short-term rates have hardly changed on the year. The Federal Reserve buying rate for acceptances has remained at ½ per cent. since 1933 and the open market rate for prime bankers' acceptances at $^7/_{16}$ per cent. for some years, with very little dealing owing to the shortage of material. The average rate on new issues of Treasury bills remained close to zero during the year, a number of issues being sold at par or with a negative yield. These rates can hardly go any lower; it is not far from the truth to say that the pressure of unused money is so great that there is no longer a positive yield on any short-term investment in which there are appreciable dealings. The excess reserves, in fact, are the funds which would be employed on the money market if

the material existed and they have become the functional substitute for the money market, that is, the buffer between the legally required cash holding and the other less liquid assets of the banks. Yields on long-term government securities have continued to fall, if somewhat irregularly, as shown in the graph. By the end of 1940 the yield on the 1960–65 Treasury bonds, the longest issue outstanding and one of the largest, was about 2 per cent. and the average yield on all outstanding Treasury bonds callable in more than 12 years was only $1^7/_8$ per cent.

In conformity with its announced policy of seeking to exercise an influence towards the maintenance of orderly market conditions, the Federal Reserve System purchased $470 million of government securities at declining prices in the autumn of 1939 and was able to sell as the market recovered. In the middle of May 1940, when there was a further substantial decline in the market, the System again bought. But conditions were different from those in 1939, offerings were not large and buyers remained in the market, so that Federal Reserve purchases amounted to only $10 million. Later advances of the market gave the opportunity for sales and on the year as a whole the government security holdings of the System declined by $300 million to the lowest level since the autumn of 1933. This contraction of Reserve Bank credit was one of the factors tending towards the decline of excess reserves in the last half of 1940. Although increased taxation under recent legislation raised revenue receipts to record levels, the U. S. Treasury has a big programme of borrowing ahead for the financing of the defence expenditure and is naturally interested in the maintenance of low borrowing rates. Besides issues for new money the Treasury has the constant renewal and consolidation of the short and middle-term debt to consider and possible conversions of bonded debt.

No long-term indebtedness matured or was callable in the years 1936–39 but from 1940 the prospect of another period of conversions was opened, particularly of bonds bearing interest above 3 per cent. issued before 1934. $350 million $3^3/_8$ per cent. bonds 1940–43 were called for June 1940 and $540 million for March 1941 and replaced by Treasury bonds with lower interest rates: in July 1940 $680 million 14 to 16-year bonds were issued at $2\frac{1}{4}$ per cent. and in March 1941 the 1941–43 bonds were (with some $630 million Notes) successfully exchanged into a $1,100 million issue of 7 to 9-year bonds bearing 2 per cent. interest. A few days later $1,000 million $2\frac{1}{2}$ per cent. 11 to 13-year bonds were issued, half for cash and half in exchange for Notes maturing in June 1941.

The March 1941 issues of Treasury bonds were particularly remarkable as being the first long-term public issues made since the passing of the Public Debt Act in February 1941, which abolished the tax-exemption previously enjoyed by public debt obligations and made all future issues fully taxable. Comparison of the terms with those of the issues made in July and October 1940 shows a slight hardening of the conditions for the Treasury. Indeed, government issues had, as a result of their tax-exemption privileges, an attraction for individuals in the higher tax brackets which they now lose.

In March 1941 the terms were made public of four new types of Treasury securities designed to attract permanent savings. Denominations range from a 10-cent stamp to $10,000 bonds and the yields are from 2.5 to 2.9 per cent. if held to maturity (generally twelve years), with earlier redemption possible but discouraged by a sacrifice of part of the yield. These securities naturally compete directly with the deposits of savings banks, many of which were, indeed, forced to reduce their deposit rates from 2 to 1½ per cent. early in 1941 owing to the low rates obtainable on their investments.

These low rates are a matter of some concern to all institutions into which a considerable proportion of the small savings of the country are canalised. The special report of the Federal Reserve authorities to Congress says specifically that the low interest rates "are raising serious, long-term problems for the future well-being of our charitable and educational institutions, for the holders of insurance policies and savings-bank accounts and for the national economy as a whole". Developments of the capital markets in recent years have forced these institutions more and more into government bonds (with declining yields) as an outlet for their resources. An interesting picture of the evolution as it affects life assurance companies was recently given by the President of the Fidelity Mutual Life Assurance Company in Philadelphia. The investment portfolio of 49 legal-reserve life assurance companies, holding about 92 per cent. of the total assets of such companies in the United States, had been modified as follows over the past ten years.

U. S. Life Assurance Companies.

Nature of assets	1930	1940	1930	1940
	in millions of dollars		in percentages	
Mortgages	6,992	5,343	40.5	18.9
U. S. Federal Government bonds . .	303	5,595	1.8	19.8
Other government bonds	1,022	2,355	5.9	8.3
Industrial securities	5,165	8,772	30.0	31.1
Sundry investments	3,765	6,185	21.8	21.9
Totals	17,247	28,250	100.0	100.0

Between 1930 and 1940 U. S. Federal Government bonds increased from 2 per cent. to 20 per cent. of the total investments, while mortgage bonds fell from over 40 to under 20 per cent. The investment earning-power had fallen from 5.03 per cent. in 1930 to 3.54 per cent. in 1939, so that in the nine years 1931–39 as a whole the net investment income of all life assurance companies was over $2,000 million less than it would have been if the rate of investment return had remained unchanged. This decline of investment earning-power was reflected in lower dividends and more expensive terms for policy holders.

The tendency for capital to be raised by U. S. corporations by the direct selling of their securities to institutional investors without public offering has assumed considerable proportions since the passing of the Securities Exchange Act of 1934 and the creation of the Securities and Exchange Commission. Such private placing of securities, besides minimising expenses, escapes the stringent provisions of the Act and the jurisdiction of the Commission.

U. S. issues of corporate bonds and notes.

In millions of dollars	New capital	Refunding	Total	of which privately placed	
				amount	percentage
1934	144	312	456	115	25.2
1935	334	1,782	2,116	335	15.8
1936	839	3,187	4,026	287	7.1
1937	817	856	1,673	285	17.1
1938	807	1,236	2,043	802	39.3
1939	287	1,596	1,883	818	43.4
1940	589	1,804	2,393	1,300 *	54.3

Source: Commercial and Financial Chronicle and New York Times. * Estimated.

The value of bonds and notes placed privately in 1940 was far higher than in any previous year and exceeded half the total issues for new money and for refunding purposes. An analysis of the $2,527 million privately placed in the years 1935–39 shows that two-thirds of the issues were purchased by the five largest insurance companies and one-third by commercial banks and other institutions. As securities privately placed cannot be quoted on the stock exchanges, there is a tendency for an outside market to grow up amongst institutional investors.

Japanese Budget Accounts.

Financial year to end of March in millions of yen	Military expenditure			Total expenditure	Non-borrowed revenue (general account)	Deficit	Non-borrowed revenue	Military expenditure
	General account	China incident	Total				as percentage of total expenditure	
1937	1,078	—	1,078	2,282	1,763	519	77.3	47.2
1938	1,412	2,540	3,952	5,521	2,309	3,212	41.8	71.6
1939	1,247	4,850	6,097	8,084	2,909	5,175	36.0	75.4
1940	1,827	4,605	6,432	8,952	3,672	5,280	41.0	71.8
1941	2,304	5,460*	7,764	10,957	4,190	6,767	38.2	70.9

* Including Yen 1,000 million supplementary vote, January 1941.

Since the outbreak of war with China in the middle of 1937 the budget in Japan has been dominated by military outlay, which has absorbed more than two-thirds of total expenditure in the last few years.

Figures given for the "China incident" in the table on the preceding page are authorised issues. These issues have not always been utilised in full in the year for which they were authorised; owing to this fact the total expenditure and deficit for any particular year may be somewhat overstated. But the aggregate over the years is not far from the actual expenditure, since at the end of December 1940 only Yen 875 million of the War Expenditure Special Account bonds remained unissued. The deficit has been covered by continuous issues of government bonds, all at 3½ per cent. and of 11 to 17 years (with a yield of about 3.65 per cent.).

The actual placings of government bonds on the market have been made chiefly through the Bank of Japan and, in spite of their increasing volume, have been accompanied by considerable private issues, particularly of industrial bonds and shares.

Japan — total capital issues.

Calendar year in millions of yen	Government bonds	Local government bonds	Bank bonds	Industrial bonds	Shares	Total issues
1937	1,371	74	508	333	1,896	4,182
1938	3,778	131	758	663	1,895	7,225
1939	5,293	233	432	1,278	2,290	9,526
1940	6,705	207	1,296	1,315	2,979	12,503

Note: For 1937 and 1938 the figures include subscriptions to all categories of issues in Japan proper, Korea, Formosa, Sakhalien, Japanese South Sea mandates and Kuantoung leased territory: for 1939 and 1940 local government bonds for Japan proper only. The figures exclude the Deposit Bureau of the Ministry of Finance and issues for conversion or against other values than cash.

In 1939 the assimilation of government bonds proved to be slow and towards the end of 1940, as the placing became more difficult, measures were taken to limit the issues for industrial financing. In 1940 the expansion of the Bank of Japan's government bond holding, which is a measure of the non-assimilation of bonds by the other banks and institutions, was by Yen 1,500 million, nearly half of the total increase of Yen 3,100 million since December 1936. In the same four years the note issue has risen parallel to the bond holding from Yen 1,870 million to Yen 4,780 million (i. e. by 155 per cent.). Although bank rate has remained unchanged at 3¼ per cent., the market has been rather tight throughout the year and for some time the Bank of Japan has imposed higher penal rates on certain types of borrowing. With the object of ensuring the better placing of its bonds, the Japanese Government has intensified its control over the banks and in August 1940 ordered the leading banks to submit reports regarding investments, issued an ordinance regulating the employment of funds by banks and other institutions and made the temporary Capital Adjustment Law more rigorous.

In September the National Finance Council was formed, comprising the various monetary institutions throughout the country, "to fulfil their missions in closer harmony and collaboration", as the Bank of Japan, the leading member, states in its annual report.

The degree of collaboration shown by the banks in taking up the government issues of 1940 appears from the following table.

Principal holders of Japanese Government bonds.

In millions of yen	Bank of Japan	Other special banks	Ordinary commercial banks	Treasury Deposit Bureau	Savings banks	Total
December 1936 . . .	829	323	2,561	1,910	1,016	6,639
,, 1937 . . .	1,387	342	2,500	2,248	1,145	7,622
,, 1938 . . .	1,841	708	3,634	3,177	1,424	10,784
,, 1939 . . .	2,417	1,082	4,618	4,674	1,873	14,664
,, 1940 . . .	3,949	1,084	5,957	6,465	2,583	20,038
Four years' increase	3,130	761	3,396	4,555	1,567	13,399

Out of the total government internal bonded debt of Yen 27,000 million only about Yen 4,000 million is held by the public directly, savings being generally invested through banks and other institutions, which together hold some 85 per cent. of all government bonds outstanding. The total internal bonded debt (the floating debt is unimportant) before the outbreak of hostilities with China was about Yen 9,250 million, that is less than the present annual total of budget expenditure. The rapid growth of the government debt has naturally led to a corresponding increase of the debt service, which now takes about one-third of total taxation revenue (compared with one-sixth in the United Kingdom and one-tenth in Germany).

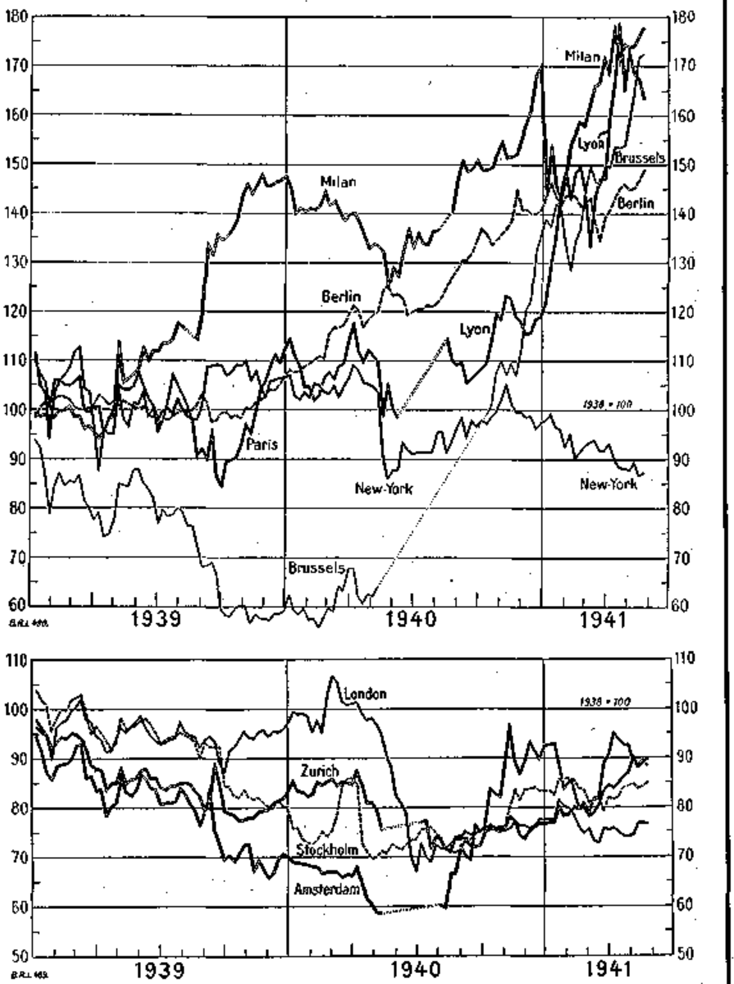
The maintenance of interest rates at low levels to permit the governments to borrow cheaply the huge amounts needed in war is the settled policy practically all over the world. The supply of savings, in the exceptional conditions now obtaining, is probably determined more by restrictions on consumption and on the distribution of dividends (whether compulsory or not) than by the height of interest rates; and the demand for capital by others than the state is generally subject to effective control in one form or another to ensure that available resources are reserved for the Treasuries. The rate of interest has, however, an important function to fulfil as an element in the valuation of capital assets: the lower the interest rate the higher should normally be the capital value of houses, land, stocks and shares, etc. It is true that in this field also the state may intervene to counteract movements which appear exaggerated or otherwise undesirable. Rents of houses may be kept down by regulations; heavy taxes may be imposed on the profits of enterprises; dealings in securities may be subjected to specially onerous duties in order to render their purchase less attractive. The effectiveness of such measures is, however, not yet fully established. Indeed, recent movements of share quotations seem to show that market valuations now take more account of other factors than of current yields.

2. STOCK EXCHANGES.

The outbreak of the war and the military events of 1940 have not left the stock exchanges unaffected, though in this field the divergence between the tendencies in different countries has been remarkable. Valuations of capital assets, which in normal times largely reflect movements in current profits and interest rates, tend under present conditions to be based on more or less uncertain anticipations as to developments in the years to come. In order to show the effects of the interplay of forces the accompanying graphs have been prepared.

Stock Exchange Quotations.

Indexes of American Economic News Service converted to base 1938 = 100.



Note: For convenience of presentation two graphs have been made, based on share indexes published by the American Economic News Service (Berlin), converted to the base of the 1938 average and representing quotations on the New York stock exchange and on eight important exchanges in Europe.

At the end of 1939 the share indexes for the United States and, in spite of the war, for the three belligerents, Germany, France and the United Kingdom, were at about the same level as at the beginning of that year. Declines occurred in 1939 on the four neutral exchanges, Zurich and Stockholm to 80, Amsterdam to

70 and Brussels to 60 per cent. of the 1938 average, while in Milan the stock market spurted from the beginning of the war, to show a rise of 50 per cent. on the year 1939.

Almost all the stock exchanges displayed a weak tendency in the first five months of 1940; on 10th May the bourses were closed in Brussels, Amsterdam and Zurich, and on 10th June in Paris. Zurich was the first to reopen, on 8th July; Amsterdam came later in July and Brussels in August, while Paris opened for bond dealing in October but remained closed for shares until March 1941. The other exchanges shown in the graph remained open without interruption. There was a mild setback in Berlin in June (reported to be due to the prospect of a short war), while in London the slump which had begun in March continued into July, taking the index below 70. All the exchanges show rises of varying degree in the second half of the year. In the spring of 1941 the share indexes for New York and four of the European exchanges (London, Zurich, Amsterdam and Stockholm) were grouped around 75 to 90, i. e. somewhat below the average for the year 1938. The indexes for Berlin, Milan, Lyons and Brussels were grouped around 150 to 180 — about twice as high as the former group.

The most spectacular rise took place in Brussels, where the share index more than doubled during the year 1940. The bourse was shut on 10th May and remained closed until 21st August, when the bond market was opened, and from 3rd September shares were gradually introduced. By 11th September all except foreign securities were listed for dealings. On 16th September the Antwerp bourse was also opened under the same conditions as in Brussels. Various precautions were taken, particularly the prohibition of forward markets, the placing of all dealing upon a cash basis and the fixing of "just quotations" some 15 per cent. above those ruling before the closing in May. But further rises had to be allowed and the "Amens" Index established for mid-October was 50 per cent. above the last figure in May: by February 1941 it was 100 per cent. higher and the rise continued at the rate of about 10 per cent. a month. The Stock Exchange Commission first issued a warning against exaggerated prices and stopped the publication of "bid" prices far above the market, while the pledging of securities as collateral was forbidden. As with relatively slight interruptions the "hausse" continued, the President of the Commission issued a new order in the middle of March 1941 prohibiting increases of quotations by more than one per cent. a day. About two weeks later a rise of two per cent. daily was permitted. The Luxemburg bourse was also reopened in August 1940, with the absence of foreign securities, which formerly accounted for nine-tenths of the paper dealt in.

The Paris bourse was shut on 10th June 1940 (four days before the entry of German troops) and, except for an unsuccessful trial during a few days at the end of July, not opened again until 14th October. On the reopening, quotations were confined to rentes and other government paper and to industrial bonds: there were no dealings in shares. As the Bordeaux bourse (where shares had been quoted) was shut when Paris opened, there remained no official market for shares in the occupied zone until the reintroduction of shares in Paris on 19th March 1941. In the meantime an unofficial office-to-office market had grown up, with quotations based upon those in the unoccupied zone.

With Paris closed or restricted in scope, the importance of the provincial markets in the unoccupied zone increased, especially in Marseilles and Lyons. The Lyons bourse had been opened on 27th August for both bonds and shares and, after some initial weakness, a bull movement set in, with particular attention paid to shares of electrical and chemical works in the unoccupied zone (less subject to raw-material difficulties than some others), as also of industries directly or indirectly having colonial or foreign interests. A number of shares doubled in price during the bull movement. In many cases the demand was so great in relation to the securities offered that there were difficulties in establishing quotations and, although rises were impressive, the shortage of material kept the turnover low. By March 1941 the yield of many shares was down to about 1 or 2 per cent.

Rentes were also strong but, owing to the impossibility of arbitrage, considerable differences of quotations developed between Paris and the provincial markets. The rise in rentes was checked at the end of the year but was resumed in the new year, when yields were reduced to about 4½ per cent. Further rises took place also in such government securities as the 4 per cent. rente 1925 (with a sterling clause) and the 4½ per cent. rente 1937 (with a dollar clause) which, on account of the foreign exchange guarantee, later became subject to the tax on the increment resulting from the sale of securities mentioned below, from which other government rentes are excepted.

Besides the regulation of technical questions as to cash payments and prior delivery of securities, special measures were taken, to enter into force on the opening of the Paris share market in March 1941, for the purpose of checking an exaggerated rise in share values and suppressing illegitimate markets: shares were to be delivered only in registered form (or deposited with a bank or stockbroker); single daily quotations were fixed and fluctuations beyond 5 per cent. in one day were not permitted (3 per cent. on provincial markets); dividends were limited and the coupon tax increased, while a tax on the increment resulting from the sale of securities was introduced on all shares bought from 19th March 1941 onwards. Foreign securities and the securities of French companies operating abroad might not be quoted in Paris (though dealt in at Lyons). The immediate result of these measures was a sharp contraction in the turnover.

The Amsterdam bourse, after a weak trend in the first months of the year, was shut on 10th May 1940 and reopened gradually from 15th July onwards, at first for government bonds and, after the establishment of rates in unofficial dealing, for shares with official quotations. The opening was firm and in the following months all securities previously quoted were listed for dealings, including American shares (generally Dutch certificates) and German bonds and shares. Some Dutch shares, especially those of companies with foreign interests, showed extraordinary rises from the low levels to which they had previously fallen. On 30th September and 24th October a number of German shares not before quoted in Amsterdam were introduced and enjoyed an active market. In November the Dutch-German payments restrictions were relaxed so that RM 5,000 per person and per month could be transferred from Germany to Holland without special permit, thus allowing the repayment of Dutch claims on Germany or the acquisition by Germans of securities quoted in Holland. The abolition of exchange regulations between Holland and Germany on 1st April 1941 opened the Amsterdam market to German purchasers without restriction and a considerable rise in quotations ensued.

At the end of 1940 the share index was some 50 per cent. above the closing figure in May but still somewhat below the 1938 average. American shares were quoted well above the New York parities, partly, but by no means wholly, for the reason that dividends were included in the price, owing to the impossibility of transfer. From 1st May 1941 the official quotation of American share certificates was suspended.

The Swiss bourses started the year weak and after a rather sharp decline were closed from 10th May 1940, at the wish of the National Bank, while outside dealings between banks were restricted. On 1st July unofficial dealings on the exchanges were permitted experimentally and on 8th July the official opening was made. Share trading was resumed, free of restrictions, while minimum prices, 5 per cent. under those of 9th May, were introduced for government bonds. But the bond market was firm and the share market quiet; the share index finished the year 1940 about 10 per cent. below the end of 1939 but showed a sustained rise in the first months of 1941. Other stock exchanges temporarily closed during the year included those of Copenhagen (shut on 9th April and reopened for bonds on 28th May and shares on 6th June) and Oslo (shut on 9th April and reopened for bonds and shares on 21st May): the Helsingfors exchange, which had been closed on the outbreak of war with Russia near the end of 1939, was reopened in April 1940. In these three cases the share index was strong at the end of 1940 and into 1941 but apparently without any very spectacular movements. The Athens share market was weak in 1940, quotations in September being about 70 per cent. of the 1938 average. Operations were suspended on 28th October, on the commencement of hostilities with Italy, but were resumed on 19th December, and from 30th January 1941 maximum and minimum prices were fixed respectively 10 per cent. above and 5 per cent. below the official rates on that day.

Of the stock exchanges that remained open throughout 1940, those of Milan and London showed the most considerable fluctuations, Milan, however, ending nearly 20 per cent. higher and London over 20 per cent. lower on the year. Milan quotations rose sharply on the outbreak of war in September 1939 and, after some hesitation in November, upon the introduction of the capital tax, finished the year strongly. In the first months of 1940 a setback was experienced, due in part to a new tax on stock exchange profits, and accentuated in May through the imminence of Italy's entry into the war and fears of a moratorium and of the closing of the exchanges. With the beginning of hostilities, the upward movement once more gained ground, carrying the index in the autumn above the level at the end of 1939 and spurting in December 1940 to a new high, but temporary, peak. A sharp reaction was caused on 30th December 1940 and the following days, as a result of the doubling (from 10 to 20 per cent.) of the dividend tax on shares, the lowering of the maximum legal dividend rate from 8 to 7 per cent. and the imposition of a special tax on the transformation of reserves into share capital. The share index reached its lowest point of reaction near the end of January, after which it rose again sharply, passing the December peak in March 1941. In this month the December restrictions were amended: dividends corresponding to the average distribution for the past three years were no longer subject to curtailment, while exemptions were granted from the tax on the issue of bonus shares (especially for companies which had reduced their capital during the period between 1928 and 1939). The market continued to be lively with a rising turnover in the following months. In March 1941 the yield on most shares was reckoned at about 3 per cent. compared with over 5 per cent. on government bonds.

The London stock market was buoyant from the outbreak of war up to March 1940, when a landslide started which, by the end of June, had carried the index down by more than 30 per cent. From this point a slow but steady recovery raised quotations, so that at the end of January 1941 one-third of the loss had been regained. London share prices remained depressed, however, by the weight of direct taxation (in addition to income tax at 42½ per cent., a 100 per cent. excess profits duty was imposed in 1940), while, in some cases, difficulties of valuation have made cautious quotations desirable.

The Stockholm exchange was somewhat dull with a small turnover except for a rather sharp rise in March 1940 (at the end of the Finnish-Russian war) affecting especially factory shares.

Between the outbreak of the war and the end of 1940 the index of share quotations on the Berlin bourse rose by 40 per cent. Taking advantage of the strong markets, the Prussian State Bank (Seehandlung), which had the trusteeship of the shares accepted by the Reich in payment of the tax on Jews in November 1938, continued its sales, and at the end of 1940 there remained only a very small unsold balance. In view of market conditions it was decided to reintroduce the so-called "speculation tax" (really an income tax on profits realised on the sale of shares within one year of purchase), which had been in abeyance for two years.

Two reasons for the rise in share quotations in Germany may be mentioned: the fall of long-term interest rates and the narrowness of the share market in the face of an increased demand. The rate of interest on new issues of Reich loans was reduced from 4½ per cent. at the end of 1939 to 3½ per cent. early in 1941, the yields falling accordingly. The average yield on all Reich loans outstanding was, of course, somewhat higher. With the market strong, the decline of share yields was more rapid. The officially calculated average yield for all shares dealt in (some 450–470 issues including about 50 non-dividend-paying) fell below 5 per cent. in December 1939, below 4½ per cent. in March 1940 and below 4 per cent. in September 1940; and early in 1941 it was 3¾ per cent. Commenting on this situation, the President of the Reichsbank, at the Annual General Meeting of shareholders in March 1941, said, "For months the stock exchange has been affected by a positively chronic shortage of material, which has inevitably caused an increase in prices. On an average share quotations showed a bigger rise than seems justified by the cheapening of interest. At times the yield from shares was scarcely higher than the interest rate for government securities. That is an unsound state of affairs. It is in the nature of shares that a greater risk attaches to them than to fixed-interest securities — particularly government paper".

The scarcity of material, which causes the share market to be narrow, is explained by the structure of German industrial financing. Before 1914 German industry was largely financed in two ways: by the banks or by issues of shares to the public. After the war of 1914–18, and especially after the 'twenties, extensive reorganisations and concentrations led to a fall in the volume of share capital outstanding. Further, the issue of shares, because they give voting power, had become more a method of integration and trust-building than of raising funds (which was done by issues of industrial bonds). Thus a larger proportion of a smaller aggregate volume of share capital was held off the market. The value of all shares officially quoted on the Berlin bourse since 1928 is given below.

Berlin Stock Exchange — shares officially quoted.

At end of year in millions of RM	Number of securities	Nominal value of capital	Market value
1928	838	10,990	18,240
1938	469	7,860	10,050
1939	468	7,760	10,350
1940	456	7,550*	13,110

* For all German bourses in 1940 the total was at most RM 9,000 million.

At the end of 1937 it was estimated that only one-half of the quoted shares were in the hands of the public, and this proportion may since have fallen.

The Ostmark and Protectorate stock exchanges displayed sharper rises than in the old Reich. In Vienna, after boom conditions in August and September 1940, the President of the Bourse officially prohibited, until further notice, the quotation of certain shares of the Ostmark at prices above those ruling on 2nd October. During the year 1940 some RM 2 milliard of Reich bonds and shares were introduced for dealings. The Prague stock exchange was opened for official dealing on 5th November 1940, after having been closed for over two years. The last official bourse was on 20th September 1938 but semi-official dealings have taken place since the middle of 1939. The share market is very narrow for, although 93 shares are quoted, many are in strong hands and only a part appear on the bourse.

With a sustained domestic demand as well as orders from the Reich, the market opened very strong and rose steeply. The sensitive share index of the National Bank (based on the quotations of ten important active shares), which was 125 at the time of the closing in 1938, was 253 on 5th November 1940 and rose to 267 at the end of the year. For many securities only a "bid" quotation was available, at which no deal could be made. The National Bank calculated the average yield of all shares quoted at 1.5 per cent. for December 1940 (varying between 2.2 per cent. for the machine industry and 0.8 per cent. for the sugar factories). Various control measures were taken early in 1941. In particular, the quotation of "bid" prices above those at which dealings last took place was forbidden, as well as dealings in shares outside the stock exchange at prices above those officially quoted.

Bucarest has been notable for extremely wide fluctuations in share prices: before the outbreak of war in 1939 the official general index (based on January 1926 = 100) was below 300; with a turnover up to twenty times the usual rate, oil shares doubled in price in October, while the general index rose to 600 and, with a continuing high turnover, exceeded 900 in March 1940; from this point the index slid back to under 500 in October 1940 and remained within the 500–600 range in the following months. In Budapest share quotations rose by 50 per cent. from August 1939 to January 1940, but fell away to October, losing about half the ground previously gained. From November 1940 to February 1941, a further rise of over 50 per cent. took quotations to a level about double that preceding the war. The stock exchange in Bratislava (Pressburg), capital of Slovakia, was opened on 15th October 1940 and maintained a very strong tone until the end of the year, when quotations were generally about one-third higher than at the opening.

In all cases where stock exchanges have been reopened after an abrupt close, special measures have been taken regarding uncompleted forward contracts, outstanding loans on securities (such as "prolongatie" in Amsterdam) and similar technical matters, in order to facilitate dealings. In addition to the factors which tend indirectly to weigh on share quotations (war damage, heavy direct taxation, limitation of dividends, etc.) governments or stock-exchange authorities have found it necessary to take measures to check unwarranted price rises and the development of black markets, especially in those bourses which have been recently reopened. Generally, stock exchanges have been reopened first for bonds and later for share dealing, introduced by degrees — in Paris only after five months. Other measures may be summarised as follows:

a) dealings only for cash and no forward markets (general);
b) verbal warnings, official or semi-official, against exaggerated rises of quotations (in several instances);
c) the fixing of minimum prices (Oslo);
d) fixing of maximum price rises for any single day (Brussels and Prague);
e) fixing of maximum quotations (the "price-stop" in Vienna);
f) fixing of one quotation a day (Paris);

g) prohibition on dealing outside the stock exchange at prices higher than the official quotation (Prague);
h) prohibition of publication of unsatisfied "bid" prices (Brussels and Prague);
i) prohibition of use of securities as collateral for stock exchange loans (Brussels and Paris);
j) making all shares transferred nominative and thus prohibiting dealing in bearer securities (Paris).

It is interesting to note that in the northern countries minimum prices were introduced for both bonds and shares and that in Switzerland a minimum for government bonds only was fixed (somewhat on the lines of the policy adopted in England on the outbreak of war).

Outside Europe, the slump of industrial share prices in Tokio from April to October 1940 was remarkable, quotations falling more than 20 per cent. to below the level ruling before the outbreak of hostilities with China. Rising costs and dividend restrictions as well as the imposition of strict control over commodity prices in the spring of 1940 appear to be the factors mainly responsible for the setback.

Perhaps the most paradoxical of security market behaviour in 1940 was the apathy of the New York stock exchange in the face of world events and the evolution of the United States domestic economy. The index of industrial production increased steeply during the year (well above the highest point in 1929), while both earnings and dividends rose. But share quotations fell off, so that the average return on 577 dividend-paying shares was as high as 7.2 per cent. (compared with some 2 per cent. on new issues of U. S. government securities).

It is well known that the importance of the New York stock exchange has declined since the 'twenties but the fact that the last few years have witnessed a further considerable shrinkage is not so fully realised. The table gives some comparative data relative to the share markets.

New York Stock Exchange Share Market 1929–1940.

Year	Industrial production index	Market value all shares	Brokers' borrowings	Share turnover	Price of N. Y. Stock Exchange seat	
	December figures			Yearly total	high	low
	1935-39 = 100	billion dollars	million dollars	in millions	thousand dollars	
1929	100 (1)	64.7 (2)	3,990 (3)	1,125	625	350 (4)
1936	116	59.9	1,048	497	174	89
1937	87	38.9	668	409	134	61
1938	101	47.5	754	297	85	51
1939	126	46.5	637	262	70	51
1940	138	41.9	427	208	59	32

(1) Index of Federal Reserve Board: highest June-August 1929, 114. (2) September 1929, $89.7 billion. (3) September 1929, over $8,000 million. (4) After 25 per cent. distribution of seats.

The sluggishness of the market is illustrated not only by the sagging quotations but also by the extremely limited turnover in 1940 (the smallest since 1921) and the fall of brokers' borrowings to the lowest recorded. The lack of interest is indicated in a striking way by the price of stock exchange seats — the $32,000 paid in 1940 was the lowest since 1899. Early in 1941 a seat was sold for only $27,000.

There are a number of reasons for the lack of interest in the share market. Quotations have been depressed by the increasing burden of taxation and, recently, by the continuous trickle of foreign sales on official account (which, being concentrated largely on market leaders, tends to affect the entire exchange). But a major reason for the decline in turnover is doubtless the severe regulation to which the market has been subjected since the creation of the Securities and Exchange Commission in 1934. The preference for placing bonds privately instead of by public issues and the growth of an outside market have been mentioned earlier in this chapter. This development illustrates one of the great difficulties of stock-exchange regulation: when the restrictions become severe, there is a tendency to evade them by recourse to legal or illegal outside or "black" markets, on which dealings are free and on which much higher prices may sometimes be paid than on the regular exchanges.

Falling share turnovers were not, however, confined to New York, as the following indexes, prepared for some European bourses on the basis of published material, show.

Indexes of Share Turnover 1937–40.

Based on turnover in 1937	Amsterdam	Zurich	Stockholm
1937	100	100	100
1938	49	69	61
1939	37	61	46
1940	25	36	21

It is true that turnovers in 1937 were rather high (especially in American shares) and that the stock exchanges in Amsterdam and Zurich were closed for two months in 1940; but the decline is no less remarkable, being more severe than in New York, where it was 50 per cent. from 1937 to 1940.

As stock markets decline, so bond markets gain in importance, not only relatively but usually in absolute volume and in turnover also. The table illustrates this trend in the United States. Since 1932 the volume of U. S. government bonds has more than doubled, while U. S. company bonds have remained almost stationary. The New York stock exchange is essentially a market for company shares and stocks and the table on page 172 gives a true picture of its decline. Although the bonds shown in the preceding table are officially quoted, dealings on the exchange are relatively small, the really active "over-the-counter" market being outside.

The growing significance of the bond markets, especially for government obligations, is a result of the more active part played by governments in the economy of certain countries in recent years and by all governments in time

New York Stock Exchange — market valuation of U. S. bonds quoted.

At end of year in billions of dollars	U. S. Government*	U. S. companies	Total U.S. bonds
1932	15.4	11.4	26.8
1940	36.0	12.8	48.9

* Including States, cities and Federal Corporations.

of war. But the increase of the public debt is often offset to a greater or lesser extent by the repayment of private indebtedness, and statistics to show this have been published for the United States. In Germany, the President of the Reichsbank explained in March 1938 how the increase in the debts of the Reich was counterbalanced by a decrease of private debts, so that there had been a shift of debt from private persons to public authorities, rather than an increase in the country's total indebtedness.

This shift from private to public indebtedness (on the stock exchange from shares to bonds and in the banks from advances to "investments") is accentuated in wartime, when, indeed, the growth of the public debt may well outrun the decline of private indebtedness. The growth of the domestic public debt in England from £660 million to £6,600 million, a direct outcome of the war of 1914–18, produced in the London stock exchange a bias towards bonds which is expressed in the fact that the £2,000 million 3½ per cent. War loan is the real "market leader" (in contrast to the New York "market leaders", which are still thought of as the stocks of outstanding corporations).

The growth of government debts in recent years has a striking parallel in the growth in importance of small savings invested through savings banks, life assurance companies, social insurance funds and similar institutions, which, having their liabilities expressed in fixed monetary sums, prefer to invest in bonds with a fixed nominal amount and maturity date. This is true of the United States, England, Germany and certain other countries and is well illustrated by statistics recently published in Germany.

Germany — Outstanding fixed-interest-bearing securities.

At end of year in milliards of RM	Held by institutions	Held by public	Total outstanding	Percentage of total held by institutions
1913	7.4	60.6	68.0	11
1929	5.2	15.2	20.4	26
1932	6.1	16.5	22.6	27
1939	22.9	21.4	44.3	52
1940 (August)	31.0	23.0	54.0	57

Source: Bank-Archiv — First half of January 1941
(which should be consulted for detailed notes and commentary).

This table shows that over half the bonds outstanding in Germany are held by institutions, against about one-tenth before the war of 1914–18.

Government securities, long and short, are becoming the preponderating investment of commercial and savings banks, of life assurance companies and social funds almost throughout the world. The difficulties caused by the low yields have been mentioned as regards the United States, but are in no way confined to that country and are, indeed, widespread. Another aspect of the relative decline of business and other private borrowing is the profound change in the structural form of the total indebtedness, particularly in relation to the underlying assets. In other words, there is a change from the more or less illiquid private loan, bank advance or direct mortgage to the comparatively liquid Treasury bill or "shiftable" obligation (i. e. saleable on a regular market). This, indeed, is not a new phenomenon but one observable over the past half-century and related to the development of the joint-stock principle, of the urban population and of the comparative importance of small savings and to the increase of government debts. A study made of the growth in volume of bank notes and bank deposits, of negotiable instruments, bonds, shares and other liquid or "shiftable" paper in the United States* showed that the ratio of these "liquid claims" to total national wealth rose from 15 per cent. in 1890 to 25 per cent. before the war of 1914–18 and to 40 per cent. in 1930. And there has doubtless been an increase since that time, for the Federal debt has more than doubled while the volume of notes and bank deposits is also higher. In other countries too there has been a similar growth of "liquid claims" especially in the form of government securities in recent years, claims which, for current financing purposes, the governments cannot for long allow to become illiquid through the closing of stock exchanges or in other ways. The events of 1940 showed how every effort was made to avoid moratoria and how bond markets were kept open or rapidly reopened, even in the midst of catastrophe. Because sound war financing implies the voluntary subscription of savings, government bond markets remain an important part of the relatively "free sector" in every country.

It is an ironical fact of the present times that the destruction of national wealth through warfare is facilitated by the creation of more "liquid claims", in the form of government bonds, to the aggregate wealth that remains. In England, the compulsory insurance against war damage has been introduced not only to ensure an equitable distribution of sacrifice but also to preserve the complex structure of debts and claims which has been erected. The volume of government indebtedness is everywhere growing both absolutely and in relation to the national wealth, and important problems will call for solution in the post-war period when working capital and other funds invested temporarily in government securities are wanted for their normal purposes.

---

* See "Liquid Claims and Nation Wealth" by Berle & Pederson 1934.

VI. CENTRAL BANKING DEVELOPMENTS.

Many important factors relating to central banking activity during the year have already been mentioned earlier in this Report, especially in chapters II (1) and V. At the beginning of the war, or shortly afterwards, nearly all European central-bank statutes were modified to give greater elasticity for direct lending to the governments and to allow the release of gold and foreign exchange for foreign payments without a contraction of the note circulation or of bankers' cash, and further steps in this direction were taken in 1940. The advent of war, indeed, brought an expansion of central-bank credit in most European countries for the needs of the government and, at times of emergency, to cover withdrawals of deposits by the public from the other banks. The growing liquidity of the markets as a result of government spending occasioned considerable repayments of private credit previously granted by both the central and the commercial banks, but note circulations continued to rise, in some cases with increased rapidity.

Modifications were made in the laws and statutes governing the activity of central banks to allow further direct lending to the government in France and Algeria, in Bulgaria, Turkey, Greece and Roumania during 1940. By two conventions of 29th February and 9th June 1940, the amount of provisional advances granted by the Bank of France to the government was raised to Fr.fcs 70 milliard, a limit which was nearly attained early in October but which has not been exceeded. On 25th August 1940 a special advance was granted by the Bank of France to the government to cover occupation costs, the total of permissible advances on this account being successively raised to Fr.fcs 108 milliard in May 1941. The Bank of Algeria was authorised by a law of 31st December 1940 to place at the disposal of the French Government a further advance of Fr.fcs 1 milliard and an advance of Fr.fcs 50 million to the government of Algeria, the legal maximum of the note circulation being raised at the same time from Fr.fcs 5 to 7 milliard.

Further resources for government credit were given in Bulgaria by a law of 9th March 1940: the National Bank had previously been authorised to place an amount not exceeding 20 per cent. of its paid-up capital and reserves in government or government-guaranteed securities. The new law authorised the Bank in addition to invest a sum not exceeding 140 per cent. of its paid-up capital and reserves in Treasury bonds maturing in, at most, seven years, issued to foreign firms in payment of government supplies. A law of 30th May 1940 authorised the Turkish Treasury to contract extraordinary advances from the central bank to the extent of £T 250 million. The legal limit for the temporary advances of the Bank of Greece to the Greek Government was raised from Dr. 400 million to Dr. 1,000 million by a law of 18th October 1940. In *Roumania*, by a decision of the Council of Ministers dated 29th March 1940, the National Bank's powers were widened as regards the granting of credit to agriculturists as well as to the government. The limit on the discount of agricultural bills up to nine months' maturity, previously fixed at 40 per cent. of the bill portfolio, was removed. Further, the discounting of Treasury bills by private persons had been limited to 20 per cent. of the Bank's capital, and advances or overdrafts on government or publicly-guaranteed securities to 30 per cent. of the bill portfolio, while the purchase of government or government-guaranteed securities was limited to the total of the capital and reserves. The new law authorised the General Council of the Bank to draw up temporary rules regarding these operations so long as the "exceptional circumstances" obtained.

As regards *gold reserves* new laws were passed in 1940 and revaluations were made in France (February), Holland (March), Roumania (April) and Switzerland (May), in each case the book profit going largely, if not wholly, to the government to cover defence and other expenditure. In the Protectorate of Bohemia and Moravia the gold price was lowered when the exchange was adjusted upwards to the Reichsmark at the end of September: the gold reserve of the National Bank was written down in value, special measures being taken to deal with the book loss of K. 207 million. A change was made in the law governing the Sveriges Riksbank, which had previously limited the gold holding of the Bank eligible as primary reserve to the gold held in Sweden, plus gold held abroad or in transport up to 15 per cent. of the total reserve. By a royal ordinance of 31st January 1940 the gold reserve of the Bank now constitutes all gold and bullion held by Sveriges Riksbank, wherever its location. Further, while the gold reserve remains in the books at par value, market value has been taken for the calculation of cover requirements since that time.

Modifications of laws and statutes have also been made during the year with regard to the *internal administration* of the central banks in Roumania (29th March), Yugoslavia (14th September), France (24th November) and the French colonial banks in Indo-China, Madagascar and French West Africa, as well as the Bank of Algeria.

The most interesting of these changes were those affecting the Bank of France. The reform of 1936 maintained the principle of the Bank's fundamental statutes of 1808 that the direction of the affairs of the Bank should be exercised by a governor appointed by the state and assisted by two deputy governors. But that reform replaced the fifteen regents of the Bank (elected by the two hundred largest shareholders) by a General Council of twenty members, of which only two were elected by the shareholders, nine representing economic and social interests (six chosen by the government) and nine the collective interests of the nation, chosen from amongst the highest officials. The new law of 24th November 1940 allows this organisation to continue but reduces the number of councillors from twenty to eleven: three chosen by the shareholders, four by the government from among representatives of commerce, industry and agriculture, three persons with official positions (the Director of the Caisse des Dépôts et Consignations, the Governor of the Crédit Foncier and the Director-General of the Crédit National), while one councillor is chosen from the personnel of the Bank. Thus, although the number of councillors is reduced, the shareholders are better represented and there are no longer any officials representing the various services of the government. Similar administrative reforms were made at the same time to the Crédit Foncier and the Crédit National, in both cases only the highest executive being the representative of the state.

Three European central banks suspended operations in 1940 when the Baltic States were attached to the U. S. S. R. and the rouble currency introduced. A new Bank of Issue in Brussels was constituted on 27th June 1940 by a decree of the German Military Commander for Belgium and Northern France. The Bank, which is a joint-stock company under Belgian law, has a capital of B.fcs 150 million (subscribed by the Belgian commercial banks). The Bank's statutes follow the general line of central-bank law modified by the conditions of its creation. The Bank is authorised to issue notes expressed in Belgian francs which, if issued, would be legal tender; but, as already mentioned earlier in this Report, no bank-notes have been issued — the Issue Bank having become in practice the banking department of the National Bank, entrusted particularly with relations with the occupying authorities, the management of the clearings and the accounts of the Reichskreditkassen, while the postal cheque accounts have also been transferred to it. The creation of a new central reserve bank in China has been mentioned in chapter II (1). By a decree of 10th August 1940 the Egyptian Government gave force of law to modifications made in the statutes of the National Bank of Egypt in 1939, lengthening the term for which the Bank had the note-issue privilege and making certain administrative changes.

Though actual changes in the laws and statutes governing central banks have not been numerous during the past year, measures taken affecting central banks directly or indirectly in an administrative or other capacity have far exceeded the experience of recent years. It is only necessary to mention some of the tasks carried out by central banks to indicate the wide field covered.

a) Temporary legal and other arrangements were made regarding the removal of offices and administration in times of emergency, and in some instances actual removals took place.

b) Numerous exchanges of bank-notes and other means of payment have been made in attached and occupied territories, generally involving changes of book-keeping into the new currency. In the occupied territories arrangements have been concluded, making the national currency available to the occupying authorities and providing for the withdrawal of previously issued Reichskreditkassenscheine. These central banks work with the supervision of a German Commissioner appointed by the occupying authorities.

c) Foreign exchange regulations have generally been made watertight and in many cases adapted to the German model. In Roumania the premiums given for gold produced in the country and sold to the National Bank have been changed. As European gold reserves are now mostly held outside Europe and foreign exchange reserves in sterling and dollars are largely unavailable, the importance of the Reichsmark holding has considerably increased for certain central banks, not only in volume but in turnover.

d) Numerous new bilateral clearing and payments agreements, either through the central bank or through an associated institution, have been made during the year. Of particular practical importance has been the mobilisation of clearing "Spitzen" through central-bank credit.

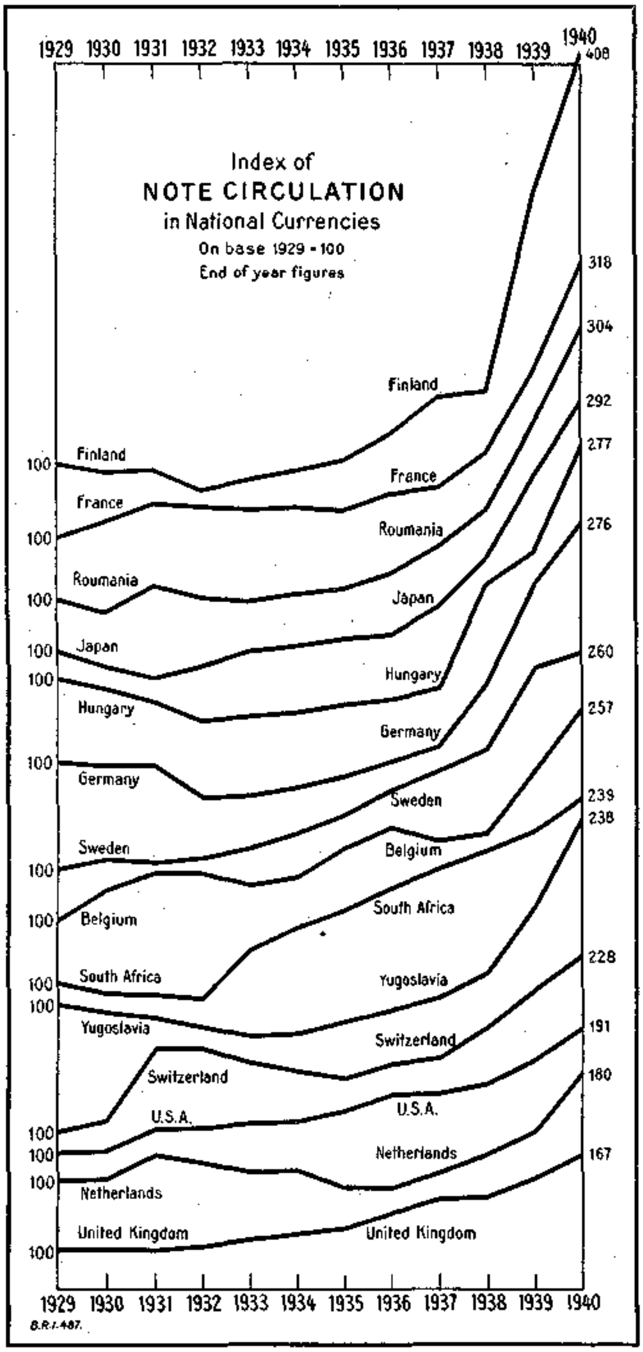
e) Mobilisations of foreign securities have taken place, as also the registration and management of enemy property and, in occupied territories, the property of the enemies of the occupying authorities (as well as the restitution of the property of the occupying authorities or their nationals previously placed under supervision).

f) Small notes have been issued in some cases to supplement the coinage, while nickel and bronze coins have been withdrawn (involving the disappearance of the well-known French "sou").

The Reichsbank in particular has been called upon for numerous administrative and other tasks. The Reichskreditkassen, which closely followed the German army in the field, were manned by Reichsbank personnel (although the institutions were, of course, completely separate) and the management of the circulation of Reichskreditkassenscheine and their withdrawal were thus supervised by Reichsbank staff. Reichsbank notes, which had previously been issued in the Saar (February 1935), Austria (March 1938), the Sudeten territory (October 1938), Memel (March 1939), Danzig (September 1939) and the incorporated territories of Poland (November 1939), were issued during 1940 in Eupen, Malmedy and Moresnet (June), and in Alsace, Lorraine and Luxemburg (August). Not only were Reichsbank notes introduced in these cases but book-keeping and other accounts were changed over into Reichsmarks.

One feature of central bank balance sheets has been common to all countries — the increase of the note circulation, particularly during the past two years. The accompanying graph gives end-of-year figures for eleven European and three overseas countries. Certain European countries have been omitted from the statistics for lack of recent data, e.g. Italy, Spain and Norway, and others owing to the incomparability of the data, e.g. Czecho-Slovakia. In other instances, such as Austria, Danzig and the three Baltic States, the banks of issue have been incorporated as branches of other central banks.

The note circulations at the end of 1929 have been taken as the basis for the calculation of indexes which give the proportionate increase of note circulation in the countries covered by the graph on the next page. Although differences and



similarities are thus brought out by juxtaposition, a warning must be uttered regarding too close a comparison. Changes in gold values have been considerable but the movement of prices, particularly retail prices and wages, in the countries concerned is probably the most realistic criterion, and it should be remembered that for nearly all of the countries shown in the graph retail prices were, on the average of 1940, below the level of 1929 (the important exception being Japan with a 40 per cent. increase).

The fact that only the note circulation of the central bank has been used for the indexes, except for the United States where all "money in circulation" has been taken, does not invalidate the graph. Shortages of coin have, indeed, appeared in many countries, but generally the increase of the circulation of coin is not disproportionate to the rise in the issue of notes. Small notes to supplement the coinage have been issued by some central banks, but in Switzerland, for example, the five-franc notes at the end of 1940 did not attain 2 per cent. of the total circulation. Government notes, or Treasury notes, have generally not been issued on any scale. Reichskreditkassenscheine issued in the occupied territories during 1940 were nearly all withdrawn at the end of the year, except in France, where an amount (unpublished) remained outstanding. Issues of Rentenbank notes were made in Germany to supplement the coinage, but the inclusion of all forms of circulation would, as a matter of fact, somewhat lower the percentage increase from 1929 to 1940.

German circulating media.

At end of year in millions of RM	Reichsbank notes	Rentenbank notes (net)	Private bank notes	Coin	Total circulation of notes and coin
1929	5,044	391	184	994	6,613
1940	14,033	1,102	—	1,635	16,770
1940 as a percentage of 1929	276	282	—	164	253

The main reasons for the increase of note circulations over the last few years were mentioned in the last Annual Report. 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. Special influences were operative in some cases: the increase of foreign hoarding of Swiss notes from 1931 onwards, the rise in the price of gold in South Africa from 1932 and, for Germany, the increase of territory, especially the incorporation of Austria and the Sudeten areas in 1938, should be mentioned. The acceleration of the increase in the volume of notes in circulation in the last two years is in European countries to be associated with the war: in part a result of the direct or indirect financing of the government by the central bank, in part a reflection of a higher demand for liquidity by the public. The lower velocity in the agricultural sector of the economy (which has had its income position improved in many countries) must, however, be taken into account. Moreover, it is probable that mobilisation increases the need of actual cash. For these and other reasons the rise in note circulation is generally higher than the increase in "money incomes" and cannot in itself be taken as the measure of an inflationary expansion. Almost without exception note circulations have risen since 1929 more than deposits held at commercial banks, while "the other sight liabilities" of the central banks (especially the reserve balances of commercial banks) have shown highly varying movements.

The table on the next page shows the relationship between the note circulation of the central bank, the total of "other sight liabilities" and the total deposits and current accounts with the commercial banks for the years 1929 and 1940, and the percentage increase over the eleven years in the United States and in three European countries. For the United Kingdom there is a remarkable stability in the relationships, each of the three items having risen over the eleven years by about one-half, the total of the clearing banks' deposits remaining between 4½ and 5 times as great as the note circulation. For the other countries important changes in the relationship are noticeable. For the United States the money in circulation has nearly doubled, rising rather faster than total deposits with the member banks. For this country, however, the most remarkable change has been the increase in the "other sight liabilities", particularly the reserve balances of the member banks. The cash

Central Bank Note Circulations and related factors.

End-of-year figures	U.S.A. 1929 (millions of dollars)	U.S.A. 1940 (millions of dollars)	U.S.A. 1940 as percentage of 1929	France 1929 (millions of Fr.fcs)	France 1940 (millions of Fr.fcs)	France 1940 as percentage of 1929
Central Bank						
Note circulation	4,578	8,732	191	68,571	218,383	318
Total "other sight liabilities"	2,414	16,126	668	19,587	28,187 (1)	144
Commercial Banks						
Total Deposits and current accounts	33,865	46,007	136	32,682 (2)	58,448 (2)	179

End-of-year figures	Germany 1929 (millions of RM)	Germany 1940 (millions of RM)	Germany 1940 as percentage of 1929	United Kingdom 1929 (millions of £)	United Kingdom 1940 (millions of £)	United Kingdom 1940 as percentage of 1929
Central Bank						
Note circulation	5,044	14,033	278	380	616	162
Total "other sight liabilities"	755	2,561	339	160	251	157
Commercial Banks						
Total Deposits and current accounts	21,753	34,000 (3)	156	1,889	2,800	148

(1) Without Reichskreditkassen accounts.
(2) Three large banks: Crédit Lyonnais, Comptoir National and Société Générale.
(3) Estimated at RM 33-35,000 million.

basis thus exists for a considerable expansion of member-bank deposits through the purchase of securities or other credit operations. This relative increase of the cash reserves of commercial banks is a feature of developments in a number of countries other than those shown in the table, e. g. Finland, Holland, Belgium and Denmark, etc. and appears to show for these countries the tendency for superfluous central-bank credit to return via the commercial banks and to be held, at least for the time being, as surplus deposits rather than as notes.

In Germany also, the "other sight liabilities" at the Reichsbank have risen rather more than the note circulation and, as in the other countries mentioned, this is an indication of the liquidity of the market. The percentage given for the total deposits at the commercial banks in Germany is based on the estimate of RM. 34,000 million at the end of 1940 given on page 115 and thus is liable to slight revision: the apparent relative fall in the volume of commercial bank deposits compared with the note issue must be read in the light of the large volume of foreign deposits in 1929 which had been withdrawn before 1940. The French situation is remarkable in that deposits with the three big banks fell from half of the volume of the note circulation in 1929 to about one-quarter in 1940, when the deposits of all the banks in the country would certainly have amounted to considerably less than the total note issue.

To obtain a complete picture it would naturally be desirable to trace the changes in the relationships shown in the tables through the years and to consider other factors such as the volume of savings deposits. But the table brings out the fact, which is confirmed by calculations for other countries, that generally the rise of note circulations has been more rapid than the increase in the volume of bank deposits in recent years, even in countries such as the United States, where the cheque habit is well developed.

In time of war the central banks, as the ultimate source of liquidity, are naturally exposed to heavy strain. In this connection it is pertinent to point out that both in the United Kingdom and in Germany direct borrowing from the central bank has been on a very small scale and utilised only to even out temporary irregularities of receipts and expenditures. In the calendar year 1940 the published statistics show the direct advance of the Bank of England to the Treasury at its highest point of £50 million in December, compared with an average note circulation of £580 million and total budget expenditure of £3,300 million: similarly, the working credit granted by the Reichsbank to the German Government touched RM 685 million in June compared with an average note circulation of RM 12,200 million and total receipts from taxation and borrowing of RM 60,000 million. In both cases direct advances from the central bank did not exceed 2 per cent. of annual budget expenditure.

Indirect government borrowing and other influences are, however, also of importance and, in the end, the currency system will only escape comparatively unscathed where internal war financing is effected from current taxation, and through the borrowing of genuine savings. No doubt, dangerous developments are scarcely concealed in many countries and, if they are not arrested, the task of setting right currency troubles when the war is over will be far from easy. In wartime it is inevitable that central banks, as indeed all other institutions, must come largely under government control and participate to their utmost in the effort of their countries. But their principal contribution even then should be to uphold fundamental principles, the non-observance of which would not only render post-war reconstruction and adaptation more difficult but might also impair the war effort itself.

VII. CURRENT ACTIVITIES OF THE BANK.

1. OPERATIONS OF THE BANKING DEPARTMENT.

The balance sheet of the Bank as on 31st March 1941, examined and found correct by the auditors, is reproduced in Annex I to the present Report. It shows a total of 495.8 million Swiss gold francs (of 0.2903 grammes of fine gold) against 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. With a few exceptions, which have little influence on the Bank's situation, the exchange rates in question have hardly changed since last year.

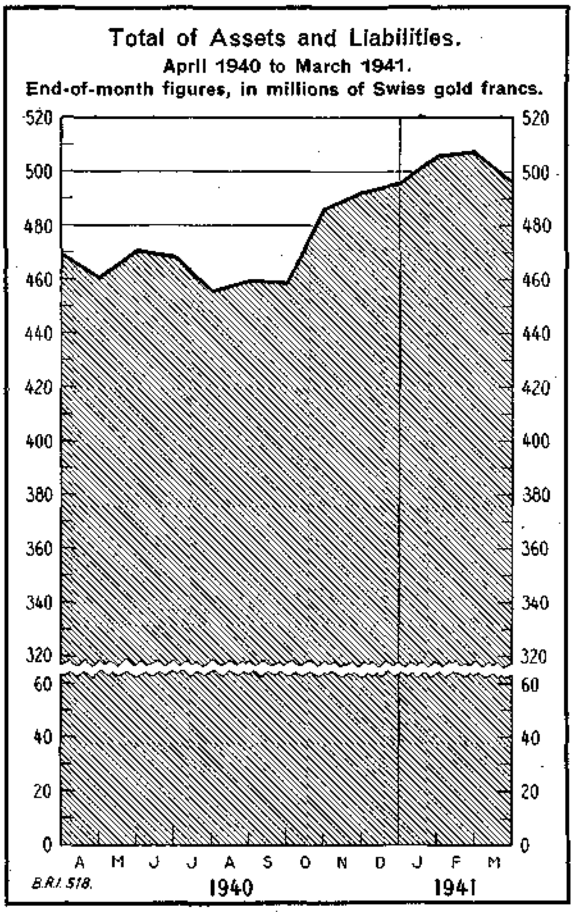
There was an appreciable decline in the volume of operations handled by the Bank during the financial year under review. The turnover, which in April and May 1940 was up to the average of the first months of war, showed a marked decrease from June onwards. The turn in the political situation inevitably had a depressing effect on the Bank's activity, and the measures by which assets in the United States belonging to belligerent and occupied countries in Europe have been made subject to licences have naturally added to the difficulties. Some complex questions have also arisen in connection with the right to dispose of assets kept with the Bank or of the Bank's own assets with central banks in cases where the status of the countries concerned had altered through the developments of the political situation.

Under the regulations issued in the United States relating to transactions *in foreign exchange, transfers of credit and the export of coins and currency* (as amended by an executive order of 10th April 1940), the Bank's operations in the United States market were made subject to the system of licences. In practice, however, these complications during the financial year under review have not prevented business although they have rendered it more difficult; for certain of the Bank's operations a general licence was granted, and special licences were obtained when required, usually within a comparatively short period.

As stated in the Introduction to this Report, the Bank has adhered to the principles of scrupulous neutrality which it laid down for itself in the autumn of 1939, confining its activities strictly to transactions whereby no question can possibly arise of conferring economic or financial advantages on any belligerent nation to the detriment of any other. Moreover, no operations are carried out which might directly or indirectly run counter to the monetary policy of the central bank in the country concerned or in practice constitute a circumvention of the legal provisions governing the disposal of the currency of that country. When the Bank has been faced with opposing claims to the same assets, it has been careful to examine the legal questions involved, having obtained, in some instances, legal opinions from independent experts, and in case of doubt it has adopted a course of action designed to protect the various interests involved.

As mentioned above, the volume of business actually transacted was appreciably smaller than in previous years, although the resources at the Bank's disposal were larger at the end of the financial year than at the beginning. In the present exceptional circumstances most transactions have involved a considerable amount of extra work. The experience thus gained is certainly not without value since the Bank has been brought into direct and intimate contact with the functioning of the currency and credit mechanism under the strain of war and has been able to follow at first hand currents of opinion in technical circles on financial problems of a more general character.

The monthly movements in the total of the Bank's balance sheet are shown in the following graph:



The total of the Bank's balance sheet, which at the end of March 1940 stood at 469.9 million Swiss gold francs, reached its minimum at the end of July with 455.4 million Swiss gold francs and its maximum at the end of February with 507.3 million. On 31st March 1941 the figure was 495.8 million — still 25.9 million higher than at the beginning of the financial year. Earmarked gold not entered in the balance sheet rose from 73.2 million Swiss gold francs on 31st March 1940 to a maximum of 89.8 million at the end of April but fell subsequently to a low of 52.8 million on 31st October. At the end of the financial year it amounted to 65.1 million Swiss gold francs.

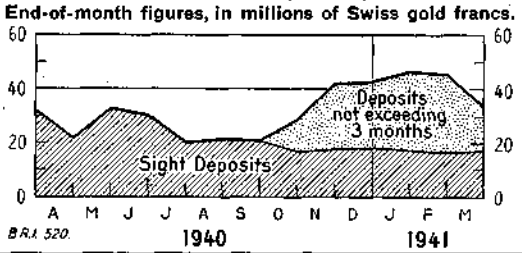
A comparison of the principal items in the Bank's balance sheet on 31st March 1940 and on 31st March 1941 calls for the following observations:

1. Liabilities.

Some of the most important movements in the composition of the Bank's liabilities relate to currency deposits of central banks for their own account. A minimum was reached on 31st July 1940 with 19.8 million Swiss gold francs, from which these deposits rose to 46.6 million on 31st January 1941. By the end of the financial year they were, however, reduced to 33.9 million Swiss gold francs. A feature of some interest is that for the first time since December 1939 deposits for a term not exceeding three months reappeared on the Bank's balance sheet and, by the end of the financial year, constituted about one-half of total deposits.

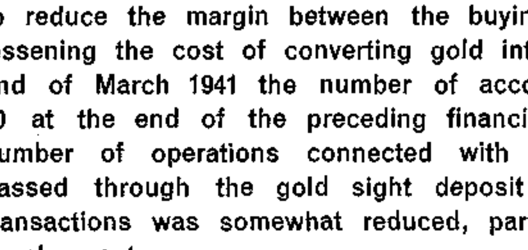
Sight deposits of central banks for account of third parties and deposits of others than central banks moved between narrow limits, their total amounting to 2.9 million Swiss gold francs at the end of the financial year.

Short-term and Sight Deposits.
End-of-month figures, in millions of Swiss gold francs.



Substantial fluctuations are also found in the total of gold deposits (at short term and sight). From 12.9 million Swiss gold francs at the beginning of the financial year they rose rapidly in the autumn to 33.2 million on 31st October. After a setback in the following month they mounted to 35.6 million Swiss gold francs at the end of February and stayed at this figure to the end of the financial year.

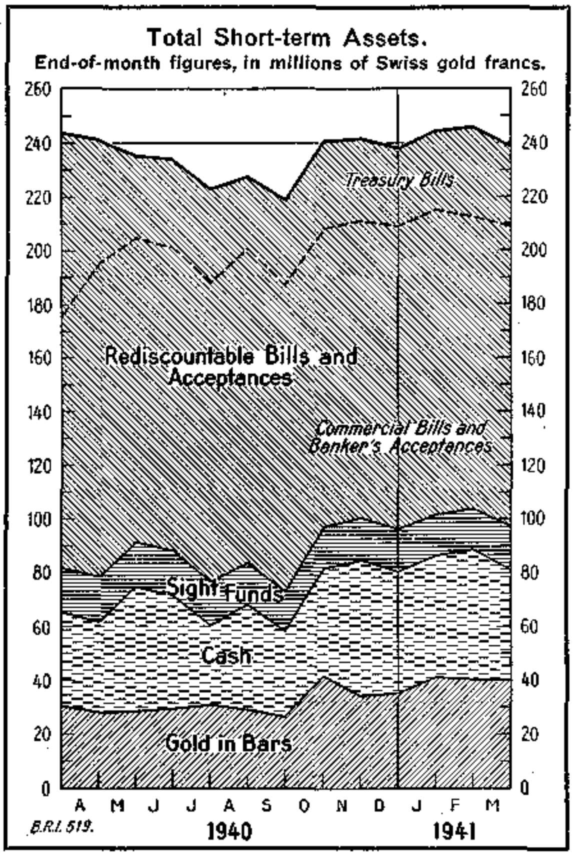
Total Gold Deposits.
End-of-month figures, in millions of Swiss gold francs.



Of the total gold deposits all except 1.6 million Swiss gold francs were at sight on 31st March 1941. The rise in the total during the year under review seems to prove that the clients of the Bank recognise the advantages which these particular facilities afford. For instance, by the use of gold deposits it is possible as a rule to reduce the margin between the buying and selling price of gold, thus lessening the cost of converting gold into currency and back again. At the end of March 1941 the number of accounts of this type was 24 against 20 at the end of the preceding financial year. As in previous years, a number of operations connected with international postal payments have passed through the gold sight deposit accounts, although the volume of transactions was somewhat reduced, particularly in Europe, by the political developments.

2. Assets.

The following graph shows the monthly movements of gold in bars, cash, sight funds and rediscountable bills and acceptances, i. e. those assets which by their character are easily realisable.



The higher amount of gold in bars at the end of the financial year than at the beginning reflects the increase in gold deposits held at the Bank. In fact, the Bank's own gold, representing the surplus of its holdings of gold in bars over its commitments expressed in a weight of gold, fell from 17.6 million Swiss gold francs on 31st March 1940 to 4.5 million a year later. In view of the shrinkage of gold operations the Bank has found it expedient, for the time being, to reduce its own stock of gold. The amount held at the end of the financial year should also be regarded as a potential cash margin.

The amount of cash underwent fairly considerable changes during the year. On 31st March 1940 it amounted to 34.8 million Swiss gold francs. The lowest point at 29.5 million was registered on 31st July, but on 30th November it had reached 50.8 million, or 10.3 per cent. of the Bank's total assets at that date. At the end of the financial year it still amounted to 41 million Swiss gold francs. Certain difficulties in finding suitable investments, together with the desirability of ensuring maximum liquidity, were the reasons for the rather large amount of cash held during the year.

Little change occurred in sight funds invested at interest, which at the end of the financial year totalled 16.2 million Swiss gold francs.

The total of the rediscountable portfolio was reduced from 161.9 million Swiss gold francs on 31st March 1940 to 141.3 million a year later. This reduction is wholly accounted for by a transfer in May of part of the Bank's investments in Treasury bills to "sundry bills and investments". The composition of the portfolio has further been altered by a change-over from Treasury bills into "commercial bills and bankers' acceptances", affecting about 18 million Swiss gold francs. This latter change should be viewed in connection with the marked increase in the Bank's holdings of Treasury bills towards the end of the preceding financial year. In the rediscountable portfolio Treasury bills amounted to 29.6 million Swiss gold francs and commercial bills and bankers' acceptances to 111.6 million at the end of the financial year, compared with 68.4 million and 93.5 million respectively at its beginning.

Among the assets of the Bank not shown in the above graph, time funds invested at interest, which at the beginning of the financial year amounted to 17.4 million Swiss gold francs, reached a maximum of 23.8 million on 31st January 1941 and were 21.5 million Swiss gold francs at the end of the financial year.

Sundry bills and investments, 206.6 million Swiss gold francs at the beginning of the financial year, touched a low of 195.1 million on 30th April 1940 and a maximum of 236.8 million on 28th February 1941. At the end of the financial year the total was 233.4 million Swiss gold francs. The distribution of the bills and investments at the beginning and the end of the financial year is shown in the table.

In millions of Swiss gold francs	31st March 1940	31st March 1941
Maturing within 3 months	110.1	108.4
3 to 6 months	80.0	57.2
Over 6 months' maturity	16.5	67.8
Total . .	206.6	233.4

By its good relations with central banks and other financial institutions the Bank has been able to overcome many difficulties with regard to the regular investment of its funds under present disturbed conditions. Particular precautions have been taken to maintain adequate cash reserves against the Bank's commitments in various currencies and in gold.

In the summer of 1940 the Bank obtained an offer from the National Bank of Hungary which covered not only the Bank's own investments in that country but also the amounts outstanding on the various central-bank credits originally granted in 1931. The offer consisted of two alternatives: (i) immediate repayment in current dollars instead of gold dollars as of 1931; or (ii) continuance of the credit on the original gold basis with provision for repayments over 8½ years. Most of the participants in the credit accepted the first alternative, while the Bank preferred the second. A similar agreement was made, covering the remainder of the Bank's investments in Hungary.

While gold operations during the year under review showed no real departure from the general type of transactions effected in earlier years, the conditions under which they were carried out were largely different. Political events and the fact that New York was the only available market for regular sales of gold had the result that most of the operations of the Bank involved movements of gold to the United States. Since it was rarely possible to effect offsets, the Bank, whether acting on its own account or for clients, was generally faced with the necessity of arranging for physical transfer of gold. Insurance premiums against war risks changed more than ever from day to day, and shipping and other restrictions created great uncertainty as to the sailings of steamers and the routes which might be used. The Bank was not able to give effect to all the requests made by its clients; but in the course of the year it has arranged for a certain number of transports — naturally only after having obtained all the necessary permits and licences. In cases where offsetting proved possible, the expense, risks and, above all, the great delay entailed by physical shipments were avoided. It should be added that as a rule the Bank has been able to furnish its clients with answers to enquiries concerning the constantly changing conditions under which gold transfers might be effected.

Credits granted via central banks to facilitate the financing of international trade have still continued but the amounts involved have been relatively small. The business, useful in itself, is interesting because it keeps alive a line of operations which may possibly be extended at some future date.

During the year under review the Bank on various occasions placed its services at the disposal of international bodies. In particular, operations have been carried out at the request of Red Cross organisations and, as a result, accounts have been opened with central banks in all continents. It must be regarded as a natural development of the Bank's activity to perform banking services for international organisations and especially those which carry on their work under international conventions.

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 5,293,909.12 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 7,962,180.65 Swiss gold francs for the tenth fiscal year. For the purpose of the Balance Sheet as at 31st March 1941, 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. 264,695.46 Swiss gold francs (1940: 398,109.03 Swiss gold francs), there remain 5,029,213.66 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 eleventh fiscal year and that, in order to complete the sum of 7,500,000 Swiss gold francs required for this purpose, an amount of 2,470,786.34 Swiss gold francs be taken from the Dividend Reserve Fund. This would reduce the Dividend Reserve Fund from 6,671,325.07 Swiss gold francs to 4,200,538.73 Swiss gold francs. The aggregate of the Legal, Dividend and General Reserves at the end of the eleventh year would then be 23,323,392.01 Swiss gold francs.

The accounts of the Bank and its eleventh Annual Balance Sheet have been duly audited by Messrs Price, Waterhouse & Co. 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 Sir Otto Niemeyer as Chairman of the Board of Directors expired in May 1940. A successor has not yet been elected.

In September Governor Pierre Fournier, whose long and cordial collaboration as an ex-officio Director had been of the utmost value to the Bank, was succeeded, upon his retirement as Governor of the Bank of France, by M. Yves Bréart de Boisanger, the new Governor, hitherto Vice-Governor.

Mr Kichio Futami, who had been appointed by the Governor of the Bank of Japan on 6th October 1939 to serve on the Board as his substitute nominee under Article 28 (1) of the Statutes, was recalled to Japan in February and Mr Yoneji Yamamoto was appointed to act in his stead.

Mr Kano and M. Galopin, whose terms of office as members of the Board expired during the year, were reappointed.

It was with the deepest regret that the Bank learned of the death on 9th June 1941 of M. Georges Janssen, Governor of the National Bank of Belgium. M. Janssen, who had served on the Board as an ex-officio Director since January 1938, rendered valuable services to the Bank and his loss is greatly deplored.

VIII. CONCLUSION.

It is not surprising that a world which, since 1914, has known little real calm and prosperity should be anxious to establish a greater measure of security and, from the difficulties of the day, turn in hope to the reconstruction after the war. The high proportion of man's productive capacity now devoted to purposes of war is proof of the tremendous technical possibilities which might be made available to improve the material welfare of all classes of society. Man has learnt to master the forces of nature and apply them to his own advantage; shall he fail, then, to master the intricacies of social and political relationships and allow his own technical achievements to be devoted with ever growing effect to destruction?

The problem of security has its political and its economic aspects with constant reactions between them. In the economic sphere the ordinary citizen finds himself exposed to the impact of movements outside his influence, to interruptions in the regular flow of goods, the result of disordered currencies and economic fluctuations. That he is willing to sacrifice part of his current income to attain a higher degree of security is shown by the mounting figures of individual insurances and also by the extension of social security schemes designed to give sustenance in old age and provision against ill health and unemployment. Such schemes, valuable as they are, solve, however, only a part of the problem: they are palliatives which serve to relieve conditions when work is unobtainable or strength fails, but they do not necessarily ensure healthy economic developments. Almost all men prefer work to enforced leisure and remuneration for their efforts to relief, but "jobs for all" can be procured only in a progressive economy when goods more plentifully produced find ready markets and amounts saved are regularly invested. From the middle of the nineteenth century to the great war, world production increased with only slight interruptions at the remarkably even rate of around 3 per cent. per annum; in old and new countries this progress ensured employment at a gradually rising standard and opportunities for the able and enterprising to advance in position and remuneration; here is at least one of the reasons why at that time the problem of social security was less urgent. Now, however, other conditions prevail and, for the most part, new remedies must be found. In one important respect, however, the experience of the pre-1914 period points to the same conclusion as that of the twenty years between the last and the present war: economic expansion presupposes a certain balance in the cost, price and profit structure, as well as continuous adaptation to changing demand and liquidation of outworn methods. Security is not won through protective measures (so often demanded by sectional interests simply to perpetuate what exists and thus to prevent adjustments even when basic conditions have changed) for such measures are more likely than not to prolong a state of depression. Stability which leads to stagnation gives no security.

In many ways the problem of full employment is comparatively easy to solve in times of rapid rearmament and war, for the state provides an unlimited market for all the instruments of war which industry can produce, while satisfaction of consumers' needs is restricted to a minimum. Peacetime economy, on the other hand, means growing production of a great variety of articles to improve the standard of living of the mass of consumers, and this involves difficult problems of maintaining a proper balance between output and purchasing power without impairing equilibrium in the credit system and in the different branches of economic life. Social duty and common sense will oblige governments to assist in the process of post-war readjustment by which production will be redirected into its peacetime channels — the only course by which the standard of living can again be raised after the decline due to the war. Resumption of foreign trade, supply of raw materials, transfer of labour and the provision of credit — these are some of the questions which will arise. As far as finance is concerned it will, in the light of the experience gained after 1918, be equally important to avoid, within each country, a runaway inflation and a violent contraction of credit — both harmful and inimical to reconstruction. Internationally, the same experience points the moral that an excessive volume of foreign credits, especially when granted at short notice, exposes the balances of payments to intolerable strains and must therefore be avoided, but that foreign trade without the lubrication of finance cannot render the services so badly needed to restore economic efficiency after a devastating war. How to profit by past experience and translate the principles of desirable financial policy into constructive action is the object of careful examination to-day in countries all over the world. Since social advance with secure employment can be attained only in a progressive economy, the future well-being of humanity will depend upon the measure of success with which these problems are solved.

Respectfully submitted,

THOMAS H. McKITTRICK,

President.

ANNEXES

BALANCE SHEET

IN SWISS GOLD FRANCS (UNITS OF 0.29032258...

ASSETS			%
I—GOLD IN BARS		40,070,131.31	8.1
II—CASH			
On hand and on current account with Banks		41,010,608.58	8.3
III—SIGHT FUNDS at interest ..		16,168,480.64	3.3
IV—REDISCOUNTABLE BILLS AND ACCEPTANCES			
1. Commercial Bills and Bankers' Acceptances	111,629,548.85		22.5
2. Treasury Bills	29,621,796.65		6.0
		141,251,345.50	
V—TIME FUNDS at interest			
Not exceeding 3 months ...		21,538,067.42	4.3
VI—SUNDRY BILLS AND INVESTMENTS			
1. Treasury Bills	75,752,840.23		15.2
2. Railway, Postal Administration and Other Bills and Sundry Investments	157,690,261.32		31.8
		233,443,101.55	
VII—OTHER ASSETS		2,346,490.89	0.5
		495,828,225.89	100.0

NOTE — The Bank holds in bar gold or in currencies free of exchange restrictions assets substantially in excess of its short term and sight deposits (Items IV and V — Liabilities). The remaining assets of the Bank are held in countries whose currencies are now subject to exchange restrictions, but as regards the Bank's assets in those countries, 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 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.

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, 1941.

AS AT MARCH 31, 1941

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.—	25.2
II—RESERVES			
1. Legal Reserve Fund	5,515,507.69		
2. Dividend Reserve Fund . . .	6,671,325.07		
3. General Reserve Fund . . .	13,342,650.13		
		25,529,482.89	5.2
III—LONG TERM DEPOSITS			
1. Annuity Trust Account Deposits	152,606,250.—		30.8
2. German Government Deposit	76,303,125.—		15.4
		228,909,375.—	
IV—SHORT TERM AND SIGHT DEPOSITS (various currencies)			
1. Central Banks for their own account:			
(a) Not exceeding 3 months	16,892,863.47		3.4
(b) Sight	16,984,135.65		3.4
		33,876,999.12	
2. Central Banks for the account of others:			
Sight		1,678,570.05	0.3
3. Other depositors:			
(a) Not exceeding 3 months	24,330.18		0.0
(b) Sight	1,156,847.30		0.2
		1,181,177.48	
V—SHORT TERM AND SIGHT DEPOSITS (Gold)			
1. Not exceeding 3 months . .	1,619,836.04		0.3
2. Sight	33,934,771.50		6.9
		35,554,607.54	
VI—MISCELLANEOUS		38,804,104.69	7.8
VII—SURPLUS			
Profit for the financial year ended March 31, 1941		5,293,909.12	1.1
		495,828,225.89	100.0

of the Bank for the financial year ending March 31, 1941, 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.

ANNEX II

PROFIT AND LOSS ACCOUNT

for the financial year ended March 31, 1941

		Swiss gold francs
Net Income from the use of the Bank's capital and the deposits entrusted to it, after necessary allowance for contingencies		7,022,432.10
Commissions earned:—		
As Trustee (or Fiscal Agent to Trustees) for International Loans		121,079.29
In connection with special credits		3,739.93
Transfer fees		53.—
		7,147,304.32
Costs of Administration:—		
Board of Directors — fees and travelling expenses	79,832.88	
Executives and staff — salaries and travelling expenses	1,413,459.60	
Rent, insurance, heating, light and water	104,420.07	
Consumable office supplies, books, publications	86,497.34	
Telephone, telegraph and postage	54,955.89	
Experts' fees (Auditors, interpreters, etc.)	12,359.71	
Cantonal taxation	35,698.12	
Tax on French issue of Bank's shares	26,931.10	
Miscellaneous	39,240.49	1,853,395.20
NET PROFIT:—		5,293,909.12

APPROPRIATION ACCOUNT

NET PROFIT FOR THE FINANCIAL YEAR ENDED MARCH 31, 1941	5,293,909.12
To the Legal Reserve Fund in accordance with Article 53 (a) of the Statutes, — 5% of 5,293,909.12	264,695.46
Available towards a dividend for the year	5,029,213.66
From the Dividend Reserve Fund	2,470,786.34
Dividend at the rate of 6% per annum on paid-up capital	7,500,000.—

BOARD OF DIRECTORS

—	Chairman.
Alexandre Galopin, Brussels Hisaakira Kano, London	Vice-Chairmen.

Dott. V. Azzolini, Rome.
Y. Bréart de Boisanger, Paris.
Baron Brincard, Paris.
Walther Funk, Berlin.
Prof. Francesco Giordani, Rome.
† Georges Janssen, Brussels.
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 Dott. Mario Pennachio	Rome.

Adolphe Baudewyns, Brussels.
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.

9th June 1941.