Possibility of Foreign Lending by Countries other than the U.S. in the Immediate Future

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In view of the extensive capital requirements of borrowing countries in 1947, the question arises, therefore, whether any countries other than the U.S. are in a position to lend dollars or other convertible currencies at the present time or to subscribe to securities issued by the Bank. In addition, other countries might extend loans in their own currencies to finance their exports, i.e., tied loans. Utilization of the 18 per cent capital subscription of member countries, paid in local currencies, has the same general economic effects as granting tied loans. This, however, is a separate problem and primary attention is concentrated in this memorandum on the possibility of dollar loans or subscription to Bank securities.

Other Possible Lenders

Among the countries whose exchange position is believed to be strong enough so that they are considered potential foreign lenders, are usually included: Canada, Argentina, Sweden, Switzerland, and South Africa. Some of these countries have already made substantial foreign loans in the form of local currency or tied loans. The situation of each of these countries can be examined briefly.

Argentina — During the war Argentina's holdings of foreign exchange and gold increased from 1519.6 million pesos at the end of 1939 to a peak of 6157 million pesos in September 1946. At the end of February 1947 these holdings were 5446 million pesos of which 3136 million pesos were gold. It is not clear at what exchange rate these holdings have been calculated, but as an absolute minimum, Argentina's resources of gold and dollars are $1,000 million. The 1946 balance of payments has not been published but it includes a larger favorable balance of merchandise trade than that in 1945 which reached 1,685 million pesos. Argentina's foreign exchange and gold assets have been widely used to pay off her external debt and repatriate ownership of her industries. Foreign loans made to European countries are about $400 million with about $300 million offered to Bolivia and Chile in loans which have not yet been ratified. Some of these loans, in particular the South American ones, involve an effort to tie in the economies of the borrowing countries to that of Argentina. In addition a loan agreement has just been made with Italy for about $50 million in connection with proposed Italian immigration to Argentina.

Although Argentina appears to be momentarily in a position to purchase International Bank securities, other factors make it extremely unlikely that Argentina can be considered to be a market for Bank bonds of any considerable magnitude. Its foreign exchange position is probably a short-run phenomenon due to present high world prices for raw materials and the question may be raised as to how far and how long the country will be able to carry on its deliberate lending policy. In addition the financing of the five year plan recently undertaken by Argentina is likely to tax its foreign exchange resources to the utmost.
A more detailed analysis of the Argentine situation is given in Appendix I attached to this memorandum.

Canada - Canada's official holdings of gold and U.S. dollars increased during the war and apparently reached a peak on June 30, 1946, with total holdings of $1,624 million. As a result of a large deficit in its current trade account with the U.S., Canada's liquid dollar resources subsequently declined and, at the end of 1946, were $1,244.9 million. They were still more than three times as high as reserves at the outbreak of the war.

Canada's current balance of payments for 1946 showed a surplus of $458 million mainly as a result of its favorable balance with the U.K. and other sterling areas only part of which was made convertible into dollars. Its balance with the U.S., however, involved a deficit of $603 million. The current balance of payments for 1947 will be generally similar to 1946 with a surplus of sterling and a deficit in U.S. dollars. The size of the drain on Canada's gold and dollar position is especially difficult to estimate since it is dependent upon the comparative levels of prices in the U.S. and Canada and upon development of alternative sources of supply in the non-dollar areas. The official forecast that Canadian holdings of gold and U.S. dollars will be down to about $700 million by mid-1948 appears to be an optimistic appraisal of probable Canadian holdings. They will be lower if the rate of deficit experienced at the end of 1946 and early in 1947 is continued. Canada has already extended loans totalling $1,844.5 million (of which $1,250 million were extended to the U.K.). Of this total, about half, $974.8 million, had been disbursed as of March 31, 1947.

In view of the diminishing gold and foreign exchange reserves of Canada and in view of its substantial loan commitments not yet disbursed, it is unlikely that Canada will, in the immediate future, extend new loans in terms of Canadian dollars or permit its nationals to make substantial net purchases of bonds of the International Bank. On the other hand, Canada would presumably not try to borrow again on the New York market unless it was felt that her dollar shortage might ease after a relatively short period, and that a credit operation did not serve to prolong a durable disequilibrium.

Sweden - Sweden entered the post-war period with a strong foreign exchange position. At the end of 1945 the Riksbank's gold and net foreign exchange holdings reached record levels of $482 million and $180 million respectively, totalling $662 million. These holdings were partially the result of an export surplus in 1945 of $160 million. In 1946 imports increased substantially and exports were made to a considerable extent to countries to whom Sweden had extended credit terms. Post-war credits granted by Sweden total about 4,000 million kroner ($1,100 million). The largest single item is 1000 million kroner granted to the Soviet Union. The U.K. has received 582 million kroner and Norway and Finland each have 400 million kroner. Of these loans, 1500 million kroner are not yet disbursed. In addition, relief grants of 640 million kroner have been made by the Government and the Swedish people.
As a result of trade developments in 1946, holdings of gold and foreign currency decreased by $100 million. From January 1, 1947 to March 15, 1947, a further decline of $144 million was experienced. Consequently, on March 15, 1947, gold holdings were 996 million kroner ($277 million) and net foreign exchange holdings were 492 million kroner ($137 million). Extensive foreign exchange and trade controls have been introduced and the probability is that 1947 will show an import surplus substantially lower than that of 1946.

In view of the reduced exchange and gold reserves and the necessity for continuing to make deliveries on foreign loans already granted, it is extremely unlikely that Sweden will be in a position either to make direct loans in kroner or to permit its citizens to subscribe to securities of the International Bank.

Switzerland - Switzerland has extensive holdings of gold and convertible currencies but is in a position in which it must maintain imports at a high level. It cannot permit an export surplus or it will have great difficulty in preventing internal inflation. At the end of January 1947 Swiss official gold holdings were $1,432 million as compared with $700 million at the end of December 1938. In addition at the end of 1946 dollar holdings were $367 million compared with $219 million at the end of 1938. Moreover, there are unquestionably substantial private holdings of gold and dollars. In 1946 Switzerland had an import trade surplus of SF 747 million. As a result of the war there has been a redirection of trade away from Germany and U.K. and toward the U.S., Argentina, Belgium and Sweden. The fact that Swiss import requirements could not be satisfied during the war (historically Switzerland has had an import surplus on its trade account) is one of the reasons for the increase in gold reserves during the war. Switzerland has not engaged in major long-term, post-war lending, but has extended several lines of credit. The total amount made available was SF 850 million ($200 million), principally to France (SF 300 million), U.K. (SF 216 million) and the Netherlands (SF 115 million). In 1946 drawings on this amount are believed to have been about SF 400 million ($94 million).

The import surplus in 1947 will probably be covered by tourism and interest receipts. Consequently, no drain on Swiss foreign exchange holdings need occur on account of its current balance of payments. Switzerland is unlikely to grant any substantial additional loans in Swiss francs because of its scarcity of goods and desire to keep prices down.

Switzerland is, however, in a position to make loans out of its gold and foreign exchange holdings so long as the proceeds of these loans are not expended in Swiss francs. This country is, consequently, a logical market for the purchase of International Bank securities. It is known that Swiss capital subscribed to the recent Norwegian bond issue (one-third of the total subscription to this issue was non-American capital). A limiting factor on the lending capacity of Switzerland is its necessity to maintain substantial gold reserves on account of the large volume of short-term foreign capital invested there.
Appendix II, attached, gives a more detailed analysis of the potentialities of the Swiss market.

South Africa — During the war, largely as a result of British war spending, South Africa increased its gold holdings from $220 million in December 1938 to $1,080 million by May 1946. In addition it paid off 90 per cent of its external sterling debt of £101 million and built up sterling balances of about £30 million. No accurate data are available on its 1946 balance of trade but it is believed to have had a substantial import surplus. Consequently, by February 1947 its gold holdings declined to $851 million. It did not have any significant dollar holdings.

Since South Africa is committed to an import surplus policy, it will use its gold holdings to accomplish this policy and is likely to be a net importer of capital for some time.

Conclusions

Pertinent conclusions are summarized in the following table:

<table>
<thead>
<tr>
<th>Country</th>
<th>Gold and Foreign Exchange Holdings, Dec. 1946</th>
<th>1946 Trade Surplus or Deficit</th>
<th>Likely to Purchase Bank Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>$1,000 a/</td>
<td>In excess of $412</td>
<td>No</td>
</tr>
<tr>
<td>Canada</td>
<td>1,245</td>
<td>$458</td>
<td>No</td>
</tr>
<tr>
<td>Sweden</td>
<td>414 b/</td>
<td>$235</td>
<td>No</td>
</tr>
<tr>
<td>Switzerland</td>
<td>1,799 a/</td>
<td>$175</td>
<td>Yes</td>
</tr>
<tr>
<td>South Africa</td>
<td>851 a/</td>
<td>Amount of deficit not available.</td>
<td>No</td>
</tr>
</tbody>
</table>

a/ February 1947
b/ March 15, 1947
c/ January 1947
ARGENTINA AS A POTENTIAL MARKET FOR INTERNATIONAL BANK BONDS

Prepared by: Alexander Stevenson
Economic Policy Studies Staff
26 June 1947

Summary and Conclusions

Although the international economic position of Argentina is at present still extremely favorable, the country's foreign lending program does not seem likely to be extended much further if indeed at all. A substantial surplus on current account may be recorded for 1947, but thereafter Argentina may well find itself caught between falling export prices and relatively rigid prices for the products it buys from abroad. If a sharp recession in agricultural prices occurs, Argentina's position could deteriorate very rapidly. Again, if recovery in European countries is slow and an acute dollar crisis appears within the next year or so, Argentina will find itself unable to pay for its imports. The Argentine government has recently undertaken a comprehensive plan for the industrialization of the country. Even under the most favorable conditions possible, the financing of that plan, which is oriented toward a greater degree of national economic self-sufficiency rather than increased international economic cooperation, will tax the country's resources to the utmost. Any substantial decline in agricultural prices would make its fulfillment impossible without external financial aid as well as technical aid. Although no authorization is at present required for remittances from Argentina on account of capital, the Central Bank exercises general surveillance over the movement of funds and may be expected to take whatever measures are necessary to facilitate the financing of the Five Year Plan. Argentina cannot therefore be regarded as a significant potential market for International Bank bonds.

Wartime Changes in the Structure of the Argentine Balance of Payments.

Before the war the Argentine balance of payments characteristically showed a substantial surplus in merchandise trade which was, however, usually more than offset by deficits in interest, dividends, and other current payments. This was met by a net inflow of funds on capital account. The country's vulnerability to external economic disturbances, arising out of its dependence on a few agricultural export products, was reflected in the wide variations in the size of its export surplus which in 1930 was replaced by a considerable deficit.

In the later war years important changes began to appear in the structure of this balance. Influenced by rising prices, exports grew to enormous proportions while imports, affected by the shortage of manufactured goods and
shipping space, fell off considerably. The export surplus thus expanded in a spectacular fashion. The wartime increase in freight rates 1/ and the decline in private remittances abroad resulted in a sharply rising surplus in other current items excluding interest and dividend payments. The latter remained high throughout the war although large amounts of foreign owned public debt and investments were repatriated with funds made available by the export surplus. The rather high figure is apt to be misleading, however, since it includes amortization payments and may well conceal further debt repatriation. As a result of these movements the net surplus on current account grew to very large proportions and, despite the repatriation operations, resulted in the accumulation of very large gold and foreign exchange holdings. 2/

In 1946 these trends were continued. The demand for agricultural products, bolstered by the needs of the devastated areas, still far exceeded the supply; shipping space was still short, while reconversion in the industrial countries hardly began to be reflected in rising Argentine imports until the latter part of the year. The movement to repatriate foreign-held debt and investment continued, culminating in the agreement with the United Kingdom providing for the liquidation of the blocked sterling balances by the transfer to local government ownership of the British-owned Argentine railways. At the end of 1946 the Argentine balance of payments position was therefore very favorable. The excess of merchandise exports over imports was higher than ever before. "Other current payments", influenced by soaring freight rates, probably also showed a record surplus. The repatriation of externally-held debt and investments had drawn down reserves of gold and foreign exchange considerably but on December 31, 1946 the country's gold reserves alone were still well over twice its total reserves of gold and foreign exchange on December 31, 1939. And at the same time the liquidation of foreign debt and investments had removed the necessity of providing for such large out-payments in the future on account of interest and dividend payments.

The Outlook for Argentine Current Receipts

Argentine export trade is dominated by a few major agricultural industries. In 1946 shipments of meat (15%), hides (9%), wool (9%), dairy produce (4%), livestock by-products (5%), cereals and linseed (25%), wheat flour and by-products (1%), and other arable farm products especially fruits (17%) accounted about 85% of the country's total exports. In the past decade there has apparently been no significant expansion in the volume of

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1/ During the war Argentina augmented her merchant marine to an important extent by using ships of Italian origin.

2/ A substantial proportion of the latter was in blocked sterling balances while large dollar balances were also frozen in New York.
agricultural production. The extraordinary export results recorded in recent years are thus derived almost exclusively from favorable price developments. By the same token — crop failures apart — the ability of Argentina to maintain the value of her exports at anything approaching 1946 levels depends on continuing high prices for these agricultural products.

The immediate outlook remains favorable to Argentina. Its main exportable surpluses in 1947 are estimated as follows:

<table>
<thead>
<tr>
<th>Crop</th>
<th>Quantity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corn</td>
<td>4,900,000 short tons</td>
</tr>
<tr>
<td>Wheat</td>
<td>2,500,000</td>
</tr>
<tr>
<td>Oats</td>
<td>300,000</td>
</tr>
<tr>
<td>Barley</td>
<td>500,000</td>
</tr>
<tr>
<td>Rye</td>
<td>100,000</td>
</tr>
<tr>
<td>Linseed oil</td>
<td>225,000</td>
</tr>
<tr>
<td>Sunflower seed oil</td>
<td>160,000</td>
</tr>
<tr>
<td>Lard</td>
<td>15,000</td>
</tr>
<tr>
<td>Wool</td>
<td>150,000</td>
</tr>
<tr>
<td>Lamb and mutton</td>
<td>100,000</td>
</tr>
<tr>
<td>Beef and veal</td>
<td>525,000</td>
</tr>
<tr>
<td>Pork</td>
<td>90,000</td>
</tr>
</tbody>
</table>

Before the war most of the Argentine oilseed crop was crushed abroad. In recent years, however, large domestic crushing facilities have been developed so that today the country has also a very considerable exportable surplus of oilseed cake. Apart from corn, where transport difficulties may preclude the

<table>
<thead>
<tr>
<th>Years</th>
<th>Physical volume of Production (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Farming</td>
</tr>
<tr>
<td></td>
<td>(Millions of pesos at 1935 prices)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Years</th>
<th>Farming</th>
<th>Industrial</th>
</tr>
</thead>
<tbody>
<tr>
<td>1935</td>
<td>2,030</td>
<td>1,430</td>
</tr>
<tr>
<td>1936</td>
<td>1,890</td>
<td>1,580</td>
</tr>
<tr>
<td>1937</td>
<td>2,040</td>
<td>1,760</td>
</tr>
<tr>
<td>1938</td>
<td>1,830</td>
<td>1,870</td>
</tr>
<tr>
<td>1939</td>
<td>2,190</td>
<td>1,920</td>
</tr>
<tr>
<td>1940</td>
<td>2,100</td>
<td>1,960</td>
</tr>
<tr>
<td>1941</td>
<td>2,500</td>
<td>2,170</td>
</tr>
<tr>
<td>1942</td>
<td>2,510</td>
<td>2,280</td>
</tr>
<tr>
<td>1943</td>
<td>2,320</td>
<td>2,320</td>
</tr>
<tr>
<td>1944</td>
<td>2,600</td>
<td>2,460</td>
</tr>
<tr>
<td>1945</td>
<td>2,180</td>
<td>2,460</td>
</tr>
</tbody>
</table>

(1) These values indicate physical volume in the sense that they are adjusted to 1935 prices.

(2) Includes building construction.

movement of more than half the bumper crop, and wool, where world stocks are relatively large, all these surpluses may well be marketed in the current year. 4/

With the exception of wool, all these products are still in extremely short supply and will remain so at least through the 1947-48 crop year. 5/ Killing frosts wrought severe damage to this year's cereal harvest in Europe. Of the Far Eastern sources of vegetable oils only the Philippines can be counted on this year for a sizable export surplus of copra. The rate of recovery of depleted European herds must necessarily be slow, especially in the case of the large animals and preference will be given, where possible, to dairy herds rather than to beef cattle.

The Argentine government has used every means to "cash in" on its favorable position. 6/ A state trading monopoly, the Argentine Institute for the Promotion of Trade, now handles practically all the large export products except wool. Profiting by the experience under the Runciman-Roca Agreement of 1936, 6-a/ it has thus placed itself in a position to minimize the monopsony power of the European buying missions and maximize its own already strong monopoly power. Buying at fixed prices from the farmers and selling at what the traffic will bear, it has obtained extremely high prices and reaped enormous profits. 7/ In recent contracts with the British Government, for example, it has sold wheat at as high as $3.64 per bushel, while bulk sales of linseed oil have been made to the United States and Great Britain at 30.25 cents per lb.

Quite clearly Argentina's position is unlikely to deteriorate seriously in the present calendar year. Prices for meat are safeguarded by the agreement of September 17, 1946 with Great Britain, by which the country undertook to take around 80 per cent of the Argentine exportable surplus of meat

4/ However, shipments of cereals for the first three months of the year were much lower than had been expected.


6/ Argentina recently refused to sign an international agreement designed to stabilize wheat prices at levels extremely satisfactory to producers.

6-a/ In this agreement signed on May 1, 1933, and in subsequent Anglo-Argentine trade and payments agreements of the thirties the British negotiators made effective use of the great buying power of the British market. Having a large import surplus with Argentina, Great Britain was able to obtain considerable concessions at the cost of guaranteeing continued access to her market. Today, with Great Britain dependent on Argentine meat supplies and having incurred large sterling debts to Argentina, the bargaining positions are reversed.

7/ A profit of 780 million pesos was reported on a single vegetable oil transaction, while profits of at least 100 per cent have been realized on wheat sales.
at prices at least 45 per cent above those fixed in the First Bulk Purchase Contract. A similar situation exists in linseed oil. Wool quotations have recently shown a downward trend, but this is unlikely to go far since most of the large stocks available are in the hands of the governments of the United States, Great Britain, and the wool-growing British Dominions, and will not be liquidated in such a way as to "spoil the market." The Argentine cereal harvest has been gathered and is being sold now on the extremely favorable terms mentioned. If present prices are maintained for the rest of the year and most of the export surpluses marketed, the total value of Argentine exports in 1947 might even top the 5,000 million peso mark.

Signs are not wanting, however, that the end of the wartime agricultural boom is approaching. Present indications are that the price peak has already been reached. It is reported, for example, that European countries are refusing to take up their quotas of fats and oils at existing prices. Prices of sunflower seed oil have slipped somewhat recently, and if current estimates prove to be correct, the supply situation, especially in grains, should be rather less critical next year. The crucial questions for Argentina therefore are "When will the down-turn come?" and "How fast and by how much will prices decline?"

No precise answer to these questions can be given, but it should be remembered that after the first World War agricultural prices broke sharply in 1920-21 long before European output reached its prewar levels, and although some of the lost ground was subsequently regained, prices never again reached their wartime peak levels, and signs of impending over-production began to appear by about 1928. It is impossible to tell whether this pattern will be repeated. One might expect that changes in market structure, such as the greatly increased importance of state trading monopolies, would have somewhat the same effect on the agricultural sector of the economy as the spread of market control had on the industrial sector, and would result in increased price rigidity. The most that can be said is that after 1947 the trend in the total value of Argentine exports will in all probability be downward, and that a sudden and sharp decline in agricultural prices within a year or so cannot be left out of account.

Receipts from port dues and freight charges may also be expected to remain rather high in 1947, but influenced by somewhat lower freight rates and by a temporary decline in the Argentine merchant marine resulting from the restitution of some vessels to Italy, they will probably be lower than in 1946. Payments for shipping services, on the other hand, will certainly rise. Personal remittances abroad are also likely to exceed the wartime low levels.

8/ The United States Government now holds about 500 million pounds of wool which the law forbids it to sell below parity.

2/ It should be noted that in 1946 exports of "various manufactured products" amounted to 443.5 million pesos. Unless markets in neighboring Latin American countries can be held by bilateral trading arrangements, that total will probably not be equalled in 1947.
so that the wartime surplus from "other current payments" will certainly be lower and might even be wiped out in the current year.

The Outlook for Argentine Current Payments

If the trend of in-payments on Argentine current account is likely to turn downward after 1947, that of current out-payments is already rising and may be expected to continue to do so for some time. Although Argentina will probably continue to supply most of its needs of textiles and other similar manufactured goods, it still imports practically all of its mechanized capital equipment. During the war agricultural machinery, transport equipment, textile machinery and similar goods could not be replaced, and a very considerable decapitalization occurred. Thus, a backlog of deferred demand for these goods was built up. With the heavy industries of Europe destroyed or crippled, most will have to come from the United States.

Argentine imports from the United States rose steadily throughout 1946, but only in the latter part of the year did the monthly totals become substantial. No Argentine statistics for the current year are available, but it is clear from American export figures that the rapidly rising trend goes on. 10/

Imports of capital equipment, however, will not be only for purposes of replacing existing assets. The Argentine Government intends to spend large sums on new plant and equipment. If the process of industrial transformation through which Argentina is now passing is to be placed in proper perspective, something must be said regarding its origin. The dislocation in world markets brought by the world crisis of 1930 precipitated far-reaching structural changes in the country's economy. It began a period of "forced-draft" industrialization which still continues. 11/ The development was at first due to external pressures, the collapse of world markets for primary products. Techniques used by the Argentine Government to safeguard the economy from the effects of the depression, increased import duties, currency depreciation, exchange control and import quotas were there, as in many other countries, emergency measures, the fleeting revival of world trade in the middle thirties was too short to have much effect on the development, and the war, cutting off imported supplies, naturally gave additional impetus to the process. But if industrialization was at first forced upon Argentina by external causes, the character of government aid and the objectives of

10/ U. S. exports of domestic and foreign merchandise to Argentina in the first three months of 1947 totalled $133.7 million compared with $190.8 million for the whole of 1946, the most notable increases being in shipments of "metals and manufactures" and "machinery and vehicles."

11/ In the decade from 1935 to 1945 the volume of industrial production increased by more than seventy per cent.
national economic policy have gradually changed. Finally in October 1946, President Peron announced a Five Year Plan for the industrialization of Argentina. From a series of ad hoc decisions taken in a period of extreme emergency industrialization had become a positive political program. The industrialization has, moreover, had one special feature which is now only too familiar, a well defined tendency toward increasing economic self-sufficiency symbolized by the recently announced decision to build a steel mill on the River Plate. This project, clearly uneconomic in a country possessing inadequate supplies of pig iron, scrap, and coal, originated in the Ministry of War and has been developed primarily to take care of Argentina's needs for war materials.

The cost of the Five Year Plan, excluding expenditures on national defense which are naturally kept secret, is estimated by the Argentine Government at 6,662.7 million pesos or 1332 million annually for the next five years. Exactly how much foreign exchange will be required to carry out the plan is not known. The emphasis placed in it upon projects such as hydroelectric development, the expansion of the railroad system, and the construction of steel- and tinplate-producing facilities makes it evident, however, that the amount will be very large. It has been estimated that for the steel mill alone at least 200 million pesos worth of machinery would have to be imported from the United States. These expenditures are to be financed out of the profits of the Argentina Institute for the Promotion of Trade, estimated by the President of the Central Bank at around 2000 million pesos for 1947.

In the coming years therefore the value of Argentine imports, especially from the United States, may be expected to rise very considerably, first to fill the backlog of deferred demand for capital equipment, and second, in connection with the carrying out of the Government's Five Year Plan. Although there may be some decline in industrial prices, these are generally rigid compared to those for agricultural products, and the total value of imports may well exceed 3500 million pesos in 1947. It should be made clear, however, that in a substantially totalitarian economy such as Argentina, the volume, kind, and direction of imports may be influenced to an important degree by decisions of government policy.

As a result of repatriation operations total foreign capital invested in Argentina has declined by at least two-thirds from a 1941 total of over nine billion pesos. With the nationalization of the railways and important public utilities, these operations would now appear to be completed. Some new direct investment in Argentina is being undertaken by American firms but no data are available to indicate whether or not it is significant in

\[12/\] Since 1944, for example, the expenditures of the Peron Government mainly on armaments, have consistently exceeded its receipts. A very considerable degree of inflation has resulted, and this in turn has speeded up an important shift in the distribution of wealth, concentrating a larger and larger proportion in the industrial and commercial sector and a smaller and smaller proportion in the hands of the farming population. This has recently been accentuated by the policies of the Argentine Institute for the Promotion of Trade in buying agricultural products at fixed prices from the farmers and retaining the profits.

\[13/\] This estimate, made by an informant of the Argentine Central Bank, is believed to undervalue German holdings. In the present circumstances, however, errors arising from this source are of no great importance.
Interest and dividend payments abroad will therefore be consistently lower than in prewar years unless substantial new American direct investments are made. These payments will still represent a substantial deficit item in the Argentine current balance, however, since many of the large items repatriated earned a low rate of return compared to most direct investments. Many of the latter are still in foreign, no doubt mainly American hands. The changed character of foreign investment will nevertheless probably be advantageous to Argentina since payments on account of direct investments are more flexible than those resulting from portfolio investments and will vary with the level of economic activity in Argentina.

The Outlook for the Argentine Current Balance

All this suggests that although the Argentine balance of payments position is still strong, it is becoming increasingly vulnerable. Exports in the current year should still be sufficient to cover even the greatly increased volume of imports which must be anticipated. In subsequent years, however, a greater decline in agricultural than in industrial prices is likely to turn the terms of trade increasingly against Argentina. A sudden break in agricultural prices would make her position critical over night.

There is a further important weakness in Argentina's position. Since the war she has appeared for the first time as an international lender. Export credits totalling 1280 million pesos have been granted to various European countries. A long-term loan of 400 million pesos was granted to Spain to consolidate old balances. The economic agreements with Chile and Bolivia concluded but not yet ratified provide for loans of 950 million pesos of which 150 million is in short-term credit. Two further prospective loans have been reported, one of 600 million pesos to Ecuador, along the lines of those to Chile and Bolivia, and a further short-term credit amounting to $134 million in a proposed payments agreement with France. No information is available on the extent to which these credits have been drawn upon, but it is evident that a significant proportion of Argentine exports is not resulting in the...
acquisition of foreign exchange. \textsuperscript{16/}

In other words, a large proportion of Argentine exports are going to "soft" currency areas on credit, while a growing volume of its purchases are from the dollar area. This does not mean that the country's foreign exchange position is in imminent danger of becoming precarious. By no means all the deficit in trade with the United States has to be met out of reserves. Argentina had a substantial favorable balance with other relatively "hard" currency areas in 1946 \textsuperscript{17/} and this should continue. Since September 17, 1946, new sterling balances have been freely convertible, and a continued substantial surplus may be expected in current transactions with the United Kingdom. \textsuperscript{18/} Further dollar loans by the United States Government and the International Bank may, of course, prevent the dollar shortage from becoming increasingly acute, but if a dollar crisis does appear, Argentina will be deeply involved. And it may be noted that in the spring of this year the rate of decline in gold holdings of the Central Bank has increased sharply. From December 31, 1946 through March 15, 1947, the Bank lost gold amounting to 583.1 million pesos. \textsuperscript{12/}

The Outlook for Argentine Foreign Lending

Several factors, therefore, such as the probable decline of Argentine export prices, the expected large increase in imports, and the threat of an acute shortage of dollars when existing credits have been used up, make it unlikely that Argentina could continue its foreign lending program much further. By economic criteria alone it is not in any real sense a mature country. In its own best interests its present and future exchange assets should probably be reserved to develop and diversify the economy especially by expanding the less "capital-intensive" industries where the annual savings of foreign exchange would be high in relation to the capital required. The more "capital-intensive" industries which need heavy imports of equipment might perhaps best be developed by foreign capital. But this is not the policy currently being followed.

\textsuperscript{16/} If it is assumed that the export credits would be drawn on at a constant rate and exhausted after two years, drafts on them would be over 400 million pesos in 1946, over 600 million in the present year and around 200 million in 1948.

\textsuperscript{17/} The favorable balance with Sweden, Switzerland, Canada, and the Union of South Africa taken together, showed a surplus of 119.2 million pesos.

\textsuperscript{18/} In 1946 this amounted to 556.7 million pesos. In the future, however, a certain percentage of the surplus will be used to pay off the remaining 125 million due on the purchase of the railroads, assuming that the agreement is ratified.

\textsuperscript{12/} It is reported that the Argentine Government, which has hitherto been transferring home large amounts of its gold held abroad, has recently shipped $21 million in gold back to New York to acquire dollar balances for purchases in the United States. (New York Times, June 5, 1947, p.10).
The government, which now has fairly complete control of economic activity, has dedicated itself to the completion of a national industrialization program which is likely to tax the country's resources to the limit even under very favorable conditions. If, on the other hand, agricultural prices decline sharply within the next year or two, Argentina will not be able to carry it through without foreign financial, as well as technical, aid. In the event that foreign exchange resources would be available for foreign loans after the needs of the Five Year Plan have been filled, the trend of Argentine policy makes it most probable that these would be used to further the program of Argentine lending to neighboring Latin American countries which is being developed in close connection with the Five Year Plan.

Although no authorization is at present required for remittances from Argentina on account of capital, these must be made at the free-market rate, and applicants for exchange in excess of 1000 pesos for such purposes must file with selling institutions a declaration as to the purpose for which the funds are to be used. These declarations are delivered to the Central Bank which exercises general surveillance over the movement of funds. The nature of that surveillance is indicated by the fact that the Central Bank and all private bank deposits were nationalized in 1945 when the Bank resisted the inflationary fiscal policy of the Peron Government. By the proposed enabling statute of the Five Year Plan the Central Bank's operations are now dedicated to the completion of that program.

In the light of all these considerations Argentina cannot be regarded as a significant potential market for International Bank bonds.
The principal forms of Swiss participation at the present time in the lending activities of the International Bank would seem to be the following:

1. Direct purchases by the Swiss Government or Government Agencies of bonds issued by the International Bank.

2. Purchases by Swiss investors of International Bank bonds (possibly denominated in Swiss Francs) issued directly on the Swiss market.


**Direct Purchases by Swiss Government**

Direct purchases by the Swiss Government of International Bank Bonds would make available to the Bank part of Switzerland's official gold and dollar holdings which at present are about $1,500 million. On Switzerland's part the procedure would entail an earning of interest which would make it financially easier for the Swiss Government to pursue its "gold sterilization" policy. Interest being paid on Swiss bonds sold domestically to accomplish the sterilization policy would be partly covered by the earnings of interest from abroad. It should also be noted that the bonds of the International Bank might be more attractive to the Swiss Government than debts of individual borrowing countries. Consequently the reserved attitude of Switzerland in respect to postwar lending hitherto maintained might be altered. Of course direct government intervention would depend upon a purely political decision, and it cannot be known without informal investigation whether there is any possibility of such a decision being taken. Assuming the possibility, the question arises as to what extent the government would be willing to dispose of its gold holdings. This matter will be considered later.

**Issuance of Bonds in Switzerland**

A direct issue of International Bank bonds in Switzerland could take place in dollar bonds but this would not in principle be much different from Swiss purchase of Bank bonds in the United States market and, therefore, will not be considered here. However, bonds might be issued in Switzerland,
denominated in Swiss Francs, or in Swiss Francs and dollars alternatively. So long as the Swiss owners of dollar assets are not allowed freely to convert these into Swiss Francs at the official rate, and there is a risk of a franc revaluation, bonds denominated in Swiss Francs would seem to be more attractive to the Swiss capital market than dollar bonds. This is illustrated by the fact that the so-called "financial dollars" (not freely convertible into francs) are still quoted in Switzerland with a discount of about 12 per cent. Since the Bank, however, would receive its interest and amortization payments in dollars, it would be risky to issue bonds in Swiss Francs at present. The situation might change, of course, in the future if the Swiss probably would be willing to allow all dollars to be converted into Swiss Francs. (Recently interest receipts from the U.S. were made convertible into Swiss Francs.) In any case the issuing of bonds in Swiss Francs presents such fundamental problems of policy, especially so long as Switzerland is not a member of the Bank, that this alternative need not be seriously considered at present.

It is interesting to note that a Belgian Government guaranteed Telephone and Telegraph Administration loan of SF 50 million was issued in Switzerland (nominal interest 4½ per annum; price of issue 99; maturity 12 years) on May 24, 1947, and it had originally been planned to offer to the Swiss subscribers the possibility of paying part of the loan in dollars, but this was dropped. However, it has been unofficially reported that arrangements were considered to enable Belgium to buy "finance dollars" out of proceeds of the loan. Whether such dollars have actually been purchased is not known here.

Swiss Purchases on U.S. Market

Purchase of International Bank Bonds issued in the United States by Swiss investors probably presents the most important practical possibility of participation of Swiss capital in the activities of the Bank.

The factors influencing the decisions of the Swiss investors in this respect seem mainly to be the yield of the International Bank Bonds, the risk involved as estimated by the investors, and the reconversion possibilities in case they should wish later on to switch back to Swiss securities. The possibility of a franc appreciation constitutes a special risk factor.

At present the level of interest rates in Switzerland is slightly above that in the U.S. The recent issues of Swiss Government bonds have been at a nominal rate of interest of 3½ per cent and 20-year bonds of this type are quoted at 101-102, while 10-year bonds are quoted a little above 102. The effective yield is about 3.15 per cent for 20-year bonds and about 3.00 per cent for 10-year bonds. How much above these yields the Bank bonds would have to go to appeal to larger groups of Swiss investors will depend mostly on risk considerations. The terms of the Belgian loan mentioned above seem to suggest that effective yields on foreign loans much below 4 per cent per annum will not appeal strongly to Swiss investors.
It is probable that the attitude of the U.S. market toward the bonds of the Bank will strongly influence the risk evaluation of the Swiss, as will, of course, the loan policy of the Bank. In general, the opinion might be ventured that the Swiss market, small and well-informed as it is, would be more impressed by the guarantee of the 44 member governments, and possibly more familiar with the European reconstruction problems, than would the U.S. investors and, therefore, would be perhaps less hesitant about accepting the bonds of the Bank. At present this may be counter-balanced by the fact that Switzerland is not a member of the Bank and by the fear of a revaluation of the Swiss franc. If Switzerland entered the Bank (and thus also the Fund, which would tend to clarify also the exchange rate problem) this would unquestionably mean a substantial strengthening of the position of the Bank's bonds on the Swiss market.

That dollars derived from non-commercial transactions cannot be freely converted into Swiss Francs at the official rate of exchange, is a factor which may also to some degree act as a deterrent to potential Swiss investors. However, as already mentioned, the Swiss attitude on this point is in the process of modification. Already interest receipts may be converted and no doubt it will only be a question of time before capital transfers may also take place. It is generally assumed that the Swiss foreign exchange position soon will become somewhat less favorable (already the rise in the Swiss gold holdings seems to have stopped), in which case the Swiss National Bank will be anxious rather than reluctant to acquire dollars. In any case the problem of reconverting dollars back into francs is probably of only modest importance in respect to Swiss investments in International Bank Bonds. The Swiss Government might nonetheless, if it so wished, make a valuable contribution by promising that dollars derived from sales of such bonds would be convertible into Swiss francs at the official rate. This would be a less radical step on the part of the government than direct purchases of Bank bonds, even in case the guaranty should become effective, since the private investors would still bear both the risk of a drop in the market price of the bonds and the risk of a revaluation of the Swiss Franc, which would make all dollar investments less valuable in Switzerland.

No doubt the fear of appreciation of the franc is of greater importance than the present convertibility limitation. Although it was stated above that Switzerland's foreign exchange position was considered likely to deteriorate in the near future, following the development in Sweden and Canada, such a development is not absolutely certain and may not be rapid. Compared to 1938, the price index of Swiss exports had by 1946 risen 9 per cent above the price index for import goods (to 253 and 234 respectively with 1938 = 100). The commodities exported by Switzerland are mainly highly processed goods, whose price development is dependent to a large extent upon wage rates, while raw and semi-processed materials are prevalent among her imports. Since the raw materials seem more likely, at present, to be subject to declining prices than labor, the official Swiss apprehension concerning the development of the trade position of the country may prove unwarranted, although the present scarcity of many of Switzerland's export products no doubt in many cases has resulted in prices which even relative to raw
material and labor costs are extremely high. Should raw material prices fall substantially more than prices of manufactured products, and should this situation continue for some time in the future, an appreciation of the Swiss Franc may be necessary in the long run. Apprehension of this on the part of Swiss investors is one of the major obstacles to their willingness to purchase or hold dollar securities.

If Swiss investors were allowed to buy the bonds of the Bank by means of "finance dollars" bought at a discount, this might be especially attractive. The present discount of 11 to 12 per cent would raise the effective yield of the dollar bonds by about 1/8 measured in Swiss Francs, say from 3.00 to 3.40 per cent per annum, so long as the present official rate of exchange is maintained for the interest transfers. Should a franc appreciation take place, the investors would, if they so desired, be able to sell the bonds without any capital loss in Swiss Francs provided the franc revaluation would not exceed the discount of the "finance dollar" at the time when the purchase is made and provided, of course, that the revaluation would involve free capital conversions of the new official rate. If the present rate of exchange is maintained and all "finance dollars" later on are made convertible at this rate, the investors would be able to make a substantial profit. However, the supply of "finance dollars" may be too limited to allow substantial purchases to be made without eliminating the discount.

To the extent that Swiss investors buy dollar bonds issued by the Bank, the gold and dollar reserves of Switzerland would decline, assuming that no disbursements from the loans of the Bank take place in Switzerland. Should the yield of the bonds prove to be so attractive to the Swiss market that this decline became of dimensions considered dangerous by the monetary authorities of Switzerland, it can be taken for granted that the necessary measures to stop further investments of this kind would be taken. The Swiss Government estimate of what is a proper minimum gold and foreign exchange reserve of Switzerland will determine the limit of Swiss purchases of Bank Bonds. Whether this limit is reached or even approached depends upon the market policy of the Bank and the response thereto by the Swiss market itself.

The three possibilities hitherto examined all have in common that the Bank would take over a part of the Swiss gold and dollar holdings corresponding to the amounts purchased (leaving out of consideration the possibility of Swiss Franc subscriptions to be spent in Switzerland). Where the investors are private persons or banks, they would in most cases have to draw directly or indirectly upon the official holdings to obtain the dollars necessary to the transaction. There is, however, a possibility that Swiss owners of assets in the U.S. would be interested in buying bonds issued by the International Bank. In a way this may be said to form part of the American rather than of the Swiss market for the bonds, but in any case a close connection with the Swiss market would exist. In some cases assets are held by Swiss purely for the reason that they cannot get them converted into Swiss Francs without a loss being incurred owing to the discount on the "financial dollars". If such funds are held in the form of U.S. Government securities, the owners might be interested in getting the higher yield from the bonds of the International Bank. This special market would disappear if

1/ One of the weak spots may be the export of watches and clocks, which have the character of a semi-luxury and are threatened by competition from the expanding British watch industry. Before the war the export of clocks and watches represented more than 15% of the total Swiss exports, and since the war the total share has increased substantially.
Switzerland changed her policy and allowed conversion at the official rate — exactly the change which would stimulate interest in the Bank's bonds from the Swiss market itself.

Swiss assets in the U.S. were blocked in 1941 but are now in the process of being defrosted insofar as the assets are certified to be Swiss owned. At the end of May 1947 only a minor part of the privately-owned assets — probably about 15 per cent — had been freed, in addition to all official holdings, but rapid progress is being made. The total amount involved is not exactly known, but at the time of the 1941 census of foreign assets in the U.S., total Swiss assets were $1,211 million. Of this amount $495 million represented bullion, currency and deposits, nearly all of it being demand deposits. Of the remaining $716 million, $69 million were U.S. Government bonds, while the rest were less liquid assets such as other bonds ($31 million), stocks ($302 million), interests in Swiss-controlled enterprises ($138 million), and trusts, debts and claims. Since 1941 there has probably been some increase due to price rises, and the earning of profits and interests which it has not been possible to transfer. The fully liquid assets, however, have declined; at the end of November 1946 the short-term liabilities of American banks to Switzerland stood at $367 million against nearly $500 million at the time of the 1941 census. There is, therefore, reason to believe that Swiss holdings of U.S. bonds and similar near-liquid assets have increased considerably.

It is noteworthy that, of the $1,211 million Swiss assets in 1941, not less than $230 million (of which $45 million were bank deposits) were supposed to be owned by non-Swiss nationals. French capital, particularly, is assumed to have used Swiss banks as intermediaries.

As the Swiss assets in the U.S. are gradually released large amounts will probably be kept liquid in this country, partly as working balances and partly awaiting an early softening of the Swiss position with regard to conversion of dollar assets into Swiss Francs. Such liquid holdings as remain, plus nearly liquid assets such as government securities and the like, constitute a potential fund for purchases of International Bank Bonds. But their use for this purpose is virtually a tapping of the American market almost as much as American subscriptions proper.

Amount of the Swiss Demand on U.S. Market

Swiss assets in the U.S. can be classified as follows:

1) Official holdings kept as foreign exchange reserve (small, since the Swiss authorities have placed most of the reserve in gold).

2) This would also hold true if, contrary to expectations, Swiss owners of stocks, equities, etc. in the U.S. should to some extent try to dispose of such assets with the purpose of buying bonds of the International Bank.
2) Private working balances.

3) Investments in business enterprises, etc., partly in Swiss-controlled firms.

4) Bank deposits in excess of working balances and holdings of U.S. Government bonds and similar highly liquid assets.

The first three categories cannot at present be reckoned upon as potential sources of demand for the bonds of the International Bank. The fourth category is a possible market for the bonds of the Bank, but it may be short lived. Since the Swiss interest level is higher than the American, holdings of this kind are as a rule either speculative or involuntary, i.e. only held because they cannot be converted into Swiss Francs at the official rate. The size of the market is extremely difficult to determine. Total Swiss holdings belonging to category 4 may be rather arbitrarily estimated at $75 million, only a part of which would be used for Bank bond purchases, depending, of course, upon the terms of issue.

Amount of Swiss demand for Bonds on Swiss Market

The views of Swiss monetary authorities concerning the proper size of the gold and foreign exchange reserves of the country would determine the extent to which Switzerland, be it through government or private channels, could buy International Bank Bonds. This, of course, should be conceived elastically - there is no fixed limit down to which the Swiss will be quite willing to go, and below which they will under no circumstances go. Furthermore, the Swiss policy may change from time to time. Finally, buying of International Bank Bonds is not the only possibility of Swiss foreign lending and foreign lending is not the only thing which affects the gold reserve. That can be done in the way of a quantitative estimate of the Swiss market during the next few years, therefore, is at the most an attempt to

3/ In the long run the bonds of the Bank may acquire such a status that they will be heavily in demand even as a foreign exchange reserve.

4/ January 1947 Swiss bank deposits in the U.S. were $377 million. A minor part (not above $50 million) were official holdings, another part working balances of commercial banks and private firms. Concluding from comparable countries with more severe restrictions, the working balances might be put at about $200 million (Belgian holdings $165 million, Netherlands holdings $212 million, Swedish holdings $164 million), leaving about $125 million in "excess holdings." Bond holdings in 1941 were about $100 million. If added, this gives about $225 million. A part of this, however, is not yet released, and insofar as the Swiss owners are only intermediaries, the release may have to wait for a long time, hence the $75 million figure stated in the text. The extremely uncertain character of this computation needs hardly to be stressed.
determine what, under more or less arbitrarily chosen assumptions, may take place.

The first assumption to be made is that, with no foreign net lending, Switzerland's official gold and dollar reserve will remain substantially at the present level. It follows from what was said above of the foreign trade prospect of Switzerland that this is by no means a certainty. Developments in both directions may take place, but on balance the assumption seems defensible.

Secondly, it is supposed that no major Swiss foreign loans are made through other channels than the International Bank.

The basic fact, then, is the present size of the Swiss gold reserve about $1430 million (March 1947). Large scale accumulation of gold began in 1931. Before then, the Swiss gold reserve, although slowly increasing, did not exceed $200 million until 1930. The last half of 1931 saw a jump to $766 million in connection with the Sterling devaluation in September 1931. Allowing for temporary drops in 1933 and 1935 the position reached in 1931 was largely maintained during the thirties, and by the end of 1938 the gold reserve was $701 million. Due mainly to heavy emergency imports in 1939 and early 1940 the reserve fell to $502 million at the end of 1940. From then on, a steady increase took place, and by the end of December 1946 the gold holdings stood as $1,430 million. Later figures indicate no large movements in either direction. Roughly speaking, therefore, the Swiss gold reserve (quantitatively measured) may be said to be twice its pre-war size.

Taking the 1928 gold reserve of $170 million (SF 530 million) as reasonably sufficient for the Swiss economy, this development would point to a very substantial excess reserve. However, the present level of prices and the foreign short-term liabilities of Switzerland must be considered. Swiss retail prices today are nearly 30% above the 1928 level, and wholesale prices, which are more significant in this connection, have risen by 50% since 1928. Therefore, the SF 530 million gold reserve of 1928 would now correspond to about SF 800 million or roughly $190 million. This is only a minor increase from the 1928 figures of $170 million, and more importance is attached to the second of the points mentioned.

The exact amount of the foreign short-term liabilities of Switzerland is not known, but it is hardly unreasonable to assume that in fact the increase of the gold stock from 1929 and 1938 was due to various forms of capital flight into Switzerland and that most of the foreign-owned capital is held in liquid form, thus representing a source of potential drain on the gold reserve. The same probably holds true of a substantial part of the increase in the gold stock during the war. Even if gold sales for export are no longer allowed to be made to other than governments and central banks, and the general freedom of currency restrictions does not cover capital transactions, the Swiss no doubt consider a gold cover for these liabilities a necessity.
It might be a fair conclusion that half the war-time increase in the gold reserve, i.e., about $350 million, would indicate the maximum outflow of gold which the Swiss authorities under any circumstances likely to prevail during the next few years would allow to take place, and this figure probably exceeds materially the amount which might be deliberately lent abroad.