Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 7, 1939

To Chairman Eccles

From Emile Despres

Subject: Tentative Appraisal of the Effect of European War Upon the United States

This has undergone only slight revision, but I suggest that you substitute it for the typewritten copy previously sent to you.

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(Three copies)

MEMORANDUM TO: Chairman Eccles September 30, 1939

FROM: Emile Despres

RE: Economic Effects of European War Upon the United States

In accordance with your request, a study of the economic effects of European war upon the United States has been undertaken, and the first instalment of a memorandum on this subject is attached. The memorandum will contain three main sections and two appendices, as follows:

1. The Present Situation

2. Short Term and Longer Term Prospects

   (a) Inventories
   (b) Foreign Trade
   (c) Federal Government Receipts and Expenditures
   (d) Domestic and Capital Outlays
   (e) Conclusion

3. Implications for Policy

Appendices: 1. Financial Capacity of Foreign Countries to Purchase American Goods
2. Shipping Capacity

The first instalment covers section 1, 2(a) and 2(b); subsequent portions of the memorandum will be sent to you upon completion.

The study as a whole is designed to provide merely a first, tentative survey of the war's economic effects and implications for economic policy in the United States. It should furnish a framework from which more detailed studies of particular topics can be readily undertaken in the future.

Simultaneously with your request to me to prepare a general survey of this sort, Governor Ransom asked that a study along similar lines be undertaken by the Division as a whole. The memorandum of which the first instalment is attached is being prepared wholly in this section, but material furnished by the business and foreign sections is being drawn upon in its preparation.

TENTATIVE APPRAISAL OF THE ECONOMIC EFFECTS OF EUROPEAN WAR UPON THE UNITED STATES

The Present Situation

The buying rush which immediately followed the outbreak of war definitely assures a considerable spurt in activity and incomes in the next few months. This buying movement may be broken down into several components:

1. The largest element consisted of orders from domestic manufacturers and dealers for the purpose of expanding inventories.

2. Advance consumer buying of sugar and other staple foods was evident for a brief period.

3. Domestic orders for industrial, rail, and utility equipment are being placed in large volume. The buying wave in industrial lines has been centered most spectacularly in the machine tool industry. It is understood that machinery orders chiefly reflect delayed replacement and modernization of existing industrial capacity, rather than creation of additional capacity, and that the buying is based upon the expectation of larger business volumes. Orders for railroad and electric power equipment, on the other hand, are largely for the purpose of expanding capacity.

4. A considerable volume of foreign inquiries for American goods, particularly from Canada and Latin America, has been reported, but few of these inquiries, apart from Canadian inquiries for machinery, are believed to have resulted as yet in the placing of orders.

The feverish pace of the buying movement reflected speculative and precautionary ordering for inventory, but the movement also has included placing of sizable orders for certain types of capital goods.

This buying rush emphasized strikingly the contrast between business and financial expectations at the outbreak of war in 1939 and such expectations in 1914. At the beginning of the last war market expectations were guided by a recollection of the effects upon business of the numerous local wars, usually of brief duration, which had occurred during the hundred years after 1815. These wars had interfered in greater or less degree with ordinary business, and it was believed that a general European war would depart from precedent only in that it would interfere far more seriously with business. The long duration and the inflationary consequences of the war were entirely unforeseen. As a result of gloomy business expectations and of the world-wide banking and financial crisis which accompanied declaration of war in 1914, business, which was already in a semi-depressed state in most countries, turned sharply downward in the latter part of 1914.

Business expectations at the outbreak of war in 1939 were based directly upon memories of the powerful inflationary stimulus exerted by the war of 1914-18. In forming business judgments, little weight was given to the possible effects upon our economy of the disruption of peacetime trade in European countries, and the retrospective view of the war of 1914-18 seemed to be one in which the developments of those years were telescoped into a single episode. It was apparently forgotten that the increase in our exports which got under way late in 1914 was at first based in considerable part on the combination of high crop yields in this country and rather poor yields elsewhere, that industrial activity in the United States did not turn up until well into 1915, and that the upward sweep of commodity prices did not begin until late in that year. Moreover, little thought was given to the difference between conditions now and conditions during the last war. This was most spectacularly illustrated in the sugar market, where memories of wartime shortages and high prices led, despite existing large supplies, to a brief rush of buying by both professional traders and consumers.

The business and financial community, by basing its expectations in 1914 on the assumption that the experience of earlier wars was directly applicable, completely misjudged the economic impacts of the Great War. It is unlikely that its long duration and inflationary effects could in any event have been foreseen, but it seems appropriate to suggest that business and financial expectations at the outbreak of war in 1939, founded upon a simple projection of our last previous wartime experience, may turn out to have been as misguided in many respects as the expectations which prevailed in 1914. It would surely be dangerous to assume that the behavior of our commodity and security markets following the outbreak of war reflected a careful appraisal of the probable impacts of war upon our economy.

Short Term and Longer Term Prospects

Appraisal of the short term and longer term effects of the European war upon the American economy will be based upon the assumptions that the war will continue for several years and that the scale of actual hostilities will grow; that the United States will not enter the war; and that our embargo on arms exports to belligerents will be repealed. None of these assumptions can be regarded as certain.

(1) The failure of Great Britain and France to furnish direct military aid to Poland and the insignificant scale of the fighting in the neighborhood of the French-German border give some substance to the view that the war may perhaps be brought to a quick close after German military operations in Poland have been completed. In that event, most of the economic tendencies considered below will fail to materialize.

(2) The assumption that the United States will not enter the war provides a fairly safe basis for analyzing the short term effects of European war upon our economy, but this assumption becomes less certain in appraising the longer term impacts of war. If the United States eventually participates as a belligerent, much of the analysis here presented of the longer term economic effects of the European war upon the United States will require modification.

(3) Whether the arms embargo will be promptly lifed depends upon the decision taken by Congress at its present session. If the embargo is not repealed, increased exports of industrial machinery and of semi-finished goods only one step removed from finished armaments will serve to replace in part prohibited arms exports to belligerents, but this offset will not be complete.

These assumptions, despite the uncertainties which surround them, are in accord with the official declarations of the belligerent governments and of the President of the United States. They provide, therefore, the most suitable present basis for analysing the impacts of war upon our economy.

In analysing short term prospects, attention will be directed to an appraisal of the probable course of business during the next nine months. Whether the immediate expansion in business volumes induced by inventory buying will be followed by a period of sustained activity at the higher level or by a reaction toward earlier rates of activity depends upon (1) the size of the present inventory spurt, and (2) the speed at which less transitory factors of demand become operative.

In appraising longer term prospects, attention will be focused upon (1) the probable character of direct wartime demands, in relation to our present structure of production; and (2) the probable magnitude of the direct and indirect effects of wartime demands upon total economic activity, in relation to our present volumes of unused productive power. The policies adopted by the Federal

Government and its agencies will considerably influence the longer term effects of war demands upon our economy. If one set of policies is adopted, wartime demands will result in an exhorbitant distortion of our structure of production combined with an inadequate level of utilization of our total productive power; under different policies, the distortion of our structure of production could be somewhat moderated, and the rate of total economic activity considerably raised.

Inventories

Prior to the outbreak of war, inventories of highly fabricated goods appeared, on the basis of trade reports, to be somewhat low in relation to prevailing and prospective rates of activity, while supplies of foodstuffs and industrial raw materials were abundant. Stocking of finished goods by retailers and jobbers, and of semi-fabricated goods by manufacturers of final products, was expected to contribute to a continued, gradual expansion of business volumes during the autumn. The feverish buying which immediately followed the outbreak of war greatly exceeded, however, anything which might have been expected on these grounds. This buying movement, based upon memories of the powerful inflationary stimulus exerted by the last war, reflected an anticipation both of price increases and of possible future difficulties in obtaining deliveries.

The more recent behavior of commodity and security markets suggests that the strongly optimistic initial expectations concerning war demands may be undergoing some modification, and that the first wave of feverish inventory buying has subsided. Despite this tentative indication that the initial mood of buoyant optimism is giving way to a soberer attitude, the possibility of further extensive buying for inventory purposes should not be ruled out.

In this connection much depends upon the industrial price policies which are adopted. If it becomes evident to purchasers that price increases are being put into effect in a number of lines, anticipatory buying will be further accentuated until the point is reached at which industries have become loaded up with goods and increases in administered prices have become general. Price increases in such commodities as, for example, steel, copper, glass, and lumber, would both encourage a resumption of buying for inventory and weaken the impetus to needed capital expenditure in housing and other fields which rising activity and incomes might otherwise be expected to provide. In the event of such price increases, a sharp reaction in business volumes in late 1939 or early 1940, after the inventory spurt has run its course, seems strongly probable.

If, however, further price increases of this character can be avoided, the question arises as to the probable course of business after the stimulus of inventory accumulation has ceased. The maintenance or further expansion of business volumes will then depend upon the emergence of less transitory factors of demand. Possible sources of increased demand may be considered under three main classes: exports, expenditures of the Federal Government, and private capital outlay. Appraisal of these three items suggests that over the next nine months the contribution to income made by export sales will increase only moderately, and that this increase may be nearly offset by a small decline in the Federal Government's contribution to income. Consequently, even though private capital outlays are likely to increase considerably, business activity may be expected to drop back towards earlier levels in the early months of 1940, after inventory accumulation has run its course. Unless the Government, through its monetary and price policies and through direct encouragement to capital outlays in certain lines, makes a vigorous effort to cushion the decline in industrial volumes, the rate of industrial activity, following its present spurt, will probably decline, during the first quarter of 1940, to a level only moderately above that of August, 1939.

Foreign Trade

The basis for the conclusion that foreign trade is likely to exert only a moderate expansive effect upon our economy in the next eight or nine months may best be indicated by considering separately

1. the effects of the naval blockade imposed by Great Britain and France upon our trade with other European countries;

2. the effects of the European war upon our trade with Great Britain and France;

3. the effects of the war upon our trade with non-European countries.

1. The British-French naval blockade will probably be enforced with full vigor from the beginning, and the trade of European countries other than Great Britain and France with non-European countries will be promptly and sharply curtailed. During the first two years of the last war, a considerable volume of American goods consigned to neutral countries was allowed to pass the blockade, owing to our repeated and forceful protests against British interference with neutral shipping. On reading between the lines of the statement on neutrality policy issued on September 15 by the Secretary of State, the inference seems fairly clear that we shall not again protest strongly against British interference with neutral trade in non-contraband goods, and this inference is confirmed by the President's neutrality message of September 21, in which the recommendation was put forward that American ships be prevented from entering war zones as a means of avoiding incidents. Although several of the European neutrals have sizable gold reserves which, in view of the wartime disruption of their customary trade channels, they would be willing to utilize in purchasing needed imports from the United States and other non-European sources, the strict rationing of shipments to these countries by the British and French fleets will prevent anything more than an extremely gradual expenditure of available international reserves in payment for imported goods. As is shown in the table on the next page, our exports to countries whose trade is likely to be affected

FOREIGN TRADE OF THE UNITED STATES IN 1938
(In millions of dollars)

	Exports	Imports	Net Exports Or Imports (-)
I. Countries Affected by Naval Blockade			
Germany	$133.7	$ 92.0	$ 41.7
Poland	24.7	13.4	11.3
U.S.S.R.	70.1	24.1	46.0
Italy	58.4	41.3	17.1
Netherlands	98.4	31.4	67.0
Belgium	76.7	41.6	35.1
Switzerland	10.6	23.0	-12.4
Scandinavian countries	111.6	64.1	47.5
Other Baltic countries	15.7	20.8	- 5.1
Balkan countries	20.0	26.9	- 6.9
Unallocated grain shipments to Canada	63.8	--	63.8
TOTAL	683.7	378.6	305.1
II. United Kingdom and France			
United Kingdom	533.1	113.2	403.9
France	133.8	54.1	79.7
TOTAL	655.9	172.3	483.6
III. Non-European Countries			
Canada	411.8	267.0	144.8
Central America	264.5	223.0	41.5
South America	299.7	262.5	37.2
Japan	256.7	128.4	128.3
China	55.9	50.5	5.4
Australia & New Zealand	92.2	15.3	76.9
Philippines	86.4	94.3	- 7.9
India	35.8	58.5	-22.7
British Malaya	8.9	112.3	-103.4
Other	244.1	197.8	46.3
TOTAL	1,756.0	1,409.6	346.4
GRAND TOTAL	3,095.6	1,960.5	1,135.1

by the blockade amounted in 1938 to $684 millions, or 22 percent of our total exports; our export surplus in trade with these countries was $305 millions, or 27 percent of our total export surplus. The direct loss in our exports to countries affected by the British-French naval blockade will be partly compensated, however, by certain indirect offsets. Thus, the unavailability of German and Swedish machinery to non-European buyers should cause a shift in demand to American products, and increased British purchases of Canadian bacon and butter to replace former shipments from Denmark should tend indirectly to increase Canadian buying of United States goods.

2. The speed at which British and French purchases of goods from the United States and other non-European sources will be expanded is chiefly a function of the nature of the war and of their general wartime economic policies. During the last war, increased Government expenditure largely financed by borrowing served to enlarge the incomes of the civilian population, with the result that the belligerent governments were forced to bid higher and higher prices in the markets for materials and labor in order to compete effectively with rising civilian expenditures. In the early years of the war British and French imports felt the full impact of rising civilian outlays as well as of governmental requirements. As the war

inflation gained momentum, the growth in their imports was limited only by the productive power of non-European sources of supply and by available shipping capacity. Measures of direct economic control, such as Government priorities, rationing of civilian requirements, and price and wage fixing, were not extensively used during the last war until sheer physical limitations upon the volume of incoming supplies, combined with loss of life and of productive power in the belligerent countries, made it impossible to satisfy both civilian demands and war needs.

The outlines of British and French wartime economic policies have already become sufficiently crystallized to make it clear that they will differ sharply from those which were followed in the last war. The general character of these policies may be approximately indicated by enumerating some of the steps so far taken by the British Government; the French Government's measures, despite differences in detail, have followed a similar pattern. The steps taken by the British Government have included (1) imposition of exchange restrictions and licensing of merchandise imports and exports; (2) establishment of a new Food Ministry to centralize buying of imported foodstuffs, license wholesalers and retailers, fix prices, and ration consumption; (3) fixing of prices and rationing of supplies of key commodities, such as steel, copper, and gasoline; (4) direct Government control over the allocation of labor and the shifting of workers; (5) control of private capital flotations; (6) sharp increase both in existing direct taxes and in indirect taxes on consumption, and extension of the excess profits tax, previously confined to firms working on Government contracts; and (7) establishment of a dollar-sterling rate of slightly over $4.00, which aids in curtailing civilian consumption, in concentrating foodstuff and raw material purchases from Empire sources, and in maintaining the competitive power in overseas markets of the textile and other light consumer goods industries not fully engaged in meeting war demands.

Measures of direct control, designed to curtail civilian consumption and check non-essential capital expenditure, will provide the chief means of achieving the fullest possible application of productive resources to the filling of war needs. As has been revealed by the German experience, the system of direct control serves t~~he~~o minimize inflation of prices, costs and incomes, and to prevent an uncontrolled expansion of imports, a matter of special importance in view of the fact that Great Britain and France base their prospects of victory upon their own economic staying power and the gradual deterioration of popular morale in Germany, rather than upon quick military successes. It was announced on September 9 that the British War Cabinet "decided to base their policy on the assumption that the war will last three years or more."

One of the chief elements in British and French economic staying power consists of their ability to obtain needed supplies from abroad by drawing upon their substantial reserves of gold and mobilizable foreign assets. Careful husbanding of these reserves to keep them from being quickly dissipated in payment for non-essential imports is a central financial objective of the control measures which have been introduced. In this respect, the objective to which policies will be geared is sharply different from that of the last war. Owing to direct advances from the United States Government following our entry into the war, the capacity of Great Britain and France to finance their purchases from abroad never became a crucial problem, and gold was regarded less as a source of external buying power than as an internal reserve for currency and credit. Mobilization of the overseas investments of British and French nationals was gradual and incomplete. Most of the exchange with which to make payment for imports was obtained by borrowing abroad, chiefly from the United States but to some extent also from the British Dominions. The principal items in our balance of international payments for the period from the middle of 1914 to the end of 1918 were as follows:

(In billions of dollars)

Excess of merchandise exports		11.8
Payment effected through:		
Gold imports	1.0	
American securities returned from Europe	2.0	
Foreign loans sold to private investors in the U.S.	1.5	
Direct advances of U.S. Government after April, 1917	7.3	
TOTAL		11.8

British and French gold reserves were actually larger at the end of the war than they had been at the beginning, and the marked increase in the volume of means of payment was believed to necessitate the holding of larger gold reserves in order to protect the "soundness" of the currency.

The changed present-day attitude in Great Britain and France regarding the role of international reserves in wartime is clearly reflected in the measures already taken. In both countries mobilization of foreign balances, securities and privately held gold has been ordered, and in Great Britain gold reserves held by the Bank of England as backing for the note issue have been transferred to the Equalization Account to make such gold available as a source of external purchasing power. Although these international reserves will doubtless be drawn upon from the start to pay for essential imports, the curtailment of imports for civilian consumption will serve for a considerable period to offset the growth in imports related specifically to war needs. The rate at which international reserves are used up will therefore be quite gradual during the early months of the war, but will be increased at an accelerating rate as a widening of the scale of hostilities, consumption of war material, loss of life, and impairment of productive facilities through enemy bombing and ordinary depreciation, make necessary a larger dependence on overseas sources of supply.

If this reasoning is valid, British and French purchases of goods from the United States and other non-European countries will increase only moderately over the next nine months, but will show a progressively larger expansion as the war proceeds. Forced curtailment of civilian consumption and unneeded capital outlay, lengthening of working hours, and transfer of workers from distributive and service occupations to physical production will considerably restrict the growth of imports in the early stages of the war.

In addition, it is already apparent that Great Britain and France will seek to limit further the drafts on their international reserves by obtaining their supplies as largely as possible from Empire sources and from countries willing to take British or French goods in return. A consequence of this policy is that the bulk of British and French purchases of foodstuffs and raw materials will be made elsewhere than in the United States. Since the productive capacity of outlying countries in foodstuffs and raw materials has greatly increased since the last war, British and French war demands for American goods will be much less diversified than in 1914-18 and will be chiefly concentrated in heavy industrial products, such as munitions, chemicals, petroleum products, airplanes, ships, motor trucks, machinery and steel.

In steel, motor trucks, petroleum products, and machinery other that machine tools, American industry can now handle an enlarged foreign demand, but the remaining industries mentioned above are already working at capacity or near-capacity levels to fill existing foreign and domestic orders, and their ability to meet enlarged foreign demands will be governed by the rate at which they can expand or convert their productive facilities.

3. The outlook for United States trade with non-European countries is conditioned by the fact that reserves of gold and free foreign exchange held by these countries are generally quite limited. Although a temporary wave of inventory buying by importers in countries whose external trade is not subject to rigid controls is an immediate possibility, the magnitude of such a movement is limited by the inability or disinclination of most countries in this group to allow their external reserves to become depleted in payment for imports. Leaving aside the possibility of a brief spurt in inventory buying from abroad, the growth in our net exports to non-European countries will therefore be governed primarily by the rate at which Great Britain and France find it essential to increase their net imports from these countries. The free exchange which they receive for foodstuffs and raw materials shipped to Great Britain and France can be used to buy American goods. Thus, in addition

to the direct effect upon our trade balance of increased British and French purchases here, our net sales to non-European countries will be stimulated as an indirect result of larger British and French net purchases from them.

The growth in our net exports to non-European countries will not fully keep pace, however, with the expansion in their net exports to Great Britain and France, and the gap will be particularly marked during the early stages of the war. This gap is due chiefly to the following factors:

(1) British and French imports of a number of colonial products, such as rubber from British-owned plantations in Malaya, copper from British-owned mines in Africa, and petroleum from British-owned wells in Iraq and Iran, involve a much smaller net outlay by Great Britain than is represented by the value of the products imported, since the earnings of these enterprises are returned as income taxes to the British Treasury and as dividends to British stockholders.

(2) A considerable part of the exports of Empire countries to Great Britain and France will be made on credit; such countries as Canada, India, Australia, and New Zealand, will allow a portion of the sterling proceeds of their export shipments to remain as unspent balances in London, instead of demanding full payment by Great Britain in gold or dollar exchange which could be used by them to buy American goods. Alternatively, these accumulating sterling balances may either be funded into direct advances by the Dominion Governments to the United Kingdom, or used to repay the outstanding external debt of the Dominions. In any event, the accumulation of unspent sterling balances by the Dominions implies a larger increase in Dominion exports than in their imports from abroad, and a correspondingly smaller impact upon American exports.

(3) In most Latin American countries and other non-Empire suppliers of foodstuffs and raw materials to Great Britain and France, the process by which an expansion of exports is communicated to higher incomes, and an enlarged demand for imports, always involves some delays, and under present conditions this lag is likely to be accentuated by deliberate policy in the countries concerned, as a means of replenishing their depleted gold and exchange reserves. Thus, their purchases from us will at first respond only sparingly to the growth in their export shipments to Great Britain and France.

It may be concluded that the growth in our export balance in trade with non-European countries is likely to be quite limited during the first nine or ten months of the war, but that it will increase more rapidly as Great Britain and France are forced to enlarge their imports of foodstuffs and raw materials, and as Latin American and other non-European countries, having built up comfortable reserves of gold and exchange, become more disposed to spend on United States products the proceeds of their increased sales to Great Britain and France. The non-European demand for our goods, though likely to be somewhat more diversified than that of Great Britain and France, will be largely concentrated in capital goods and durable consumer goods. In the first place, Germany, now virtually cut off from non-European trade, has been an important supplier of machinery, chemicals, automobiles, and other highly fabricated industrial goods. In the second place, Great Britain and France will undoubtedly try, through curtailment of domestic consumption, to maintain the exporting capacity of the light consumer goods industries, such as textiles, but will find it impossible to export any significant volume of heavy industrial goods, in view of their own war requirements. Third, the war will greatly accelerate industrialization in the British Dominions and in South America, which will involve purchases of industrial equipment here.

Our export surplus, which ran close to $100 millions a month throughout 1938 and declined abruptly after the turn of the year to an average level of $57 millions for the first eight months of 1939, should increase gradually over the next eight or nine months, perhaps reaching the 1938 level by about the middle of 1940. If it is assumed that the drafts made upon British and French international reserves up to the middle of 1940 will be roughly offset by replenishment of gold and exchange reserves held by outlying countries, this would leave available for foreign net purchases of goods and services from us an amount about equivalent to the new gold produced during the period. Foreign production of new gold, excluding Russian output and a small amount produced in European countries which are affected by the naval blockade, is running at the rate of $75 to $80 millions a month, and this figure should not differ substantially from our average monthly net exports of goods and services in the nine months ending June, 1940. Although our export surplus will increase only slowly at first, the shift in composition of our exports will promptly exert a strong stimulus to capital expenditures in the industries specifically affected by foreign demands.

Parenthetically, it should be added that, although the preceding analysis has dealt only with probable tendencies in the foreign demand for American products, our trade balance actually depends upon the magnitude of this demand in relation to our demand for foreign goods. In considering the probable magnitude of the stimulus which foreign trade will furnish to the American economy, it has seemed appropriate, however, to omit consideration of this second factor because the scale upon which we buy imported goods is itself governed largely by the level of activity and incomes in this country. The probability that our exports will increase only moderately over the next nine months will therefore tend, in the absence of powerfully stimulating domestic influences, to limit the expansion of our purchases of imported goods. Nevertheless, the heavy forward buying which immediately followed the outbreak of war will undoubtedly be reflected in increased raw material imports over the next few months. During this brief period of inventory accumulation, the inflow of raw products from abroad should increase more rapidly than our shipments to foreign countries. In that event, our export surplus may be expected to decline somewhat during, say, the next three months and to begin to increase after the period of inventory accumulation has come to an end.

The preceding analysis of the impact of war upon our foreign trade may be briefly summarized. Our trade with European countries other than Great Britain and France, which produced an export surplus of $305 millions in 1938, will probably be substantially curtailed, owing to the British-French naval blockade. This direct loss in trade will be partly compensated, however, by certain indirect offsets, such as Latin American purchases from the United States of machinery formerly imported from Germany. In view of the British and French determination to draw sparingly upon their gold and exchange reserves, which constitute an important element in economic staying power, their net imports from the United States will increase only moderately during the early months of the war as increased importation of goods related directly to war needs will be offset by forced curtailment of imports for civilian consumption. The increase in net imports from the United States will later become increasingly substantial as a widening of the scale of hostilities, consumption of war material, loss of life, and impairment of productive facilities through enemy bombing and ordinary depreciation make necessary a larger dependence on overseas sources of supply. Increased

British and French demand for our goods will be largely concentrated in heavy industrial products, foodstuffs and raw materials being obtained chiefly from Empire sources and from Latin America, whose productive power is much greater than in 1914-18. Similarly, our net exports to non-European countries will increase only slowly during the early months of the war, showing an increasingly rapid expansion, however, as Great Britain and France find it necessary to enlarge their imports of foodstuffs and raw materials, and as Latin American and other non-European countries, having replenished their gold and exchange reserves, begin to spend on United States products a higher proportion of the proceeds of their increased sales to belligerents. Non-European demand for United States products, though somewhat more diversified than that of Great Britain and France, will be largely concentrated in heavy industrial products, and these combined demands will induce a progressive expansion of productive capacity in the industries specifically affected.

Combining these judgments concerning our trade with particular groups of countries, it would appear that our total exports will show only a moderate expansion over the next nine months, that over, say, the next three months the increase in imports associated with inventory accumulation in this country may cause a temporary contraction in our export surplus, and that thereafter our excess of exports will tend at first to increase only gradually. Over the longer term, however, our net exports will expand at an accelerating rate as the war proceeds. The growth in exports, both at once and over the longer term, will occur primarily in such products as munitions, chemicals, airplanes, machinery, steel, petroleum products, motor trucks, and passenger automobiles, while American agricultural products and light consumers goods, such as textiles, will be comparatively little affected by increased foreign demands. The financial capacity of foreign countries to purchase American goods, and the availability of shipping capacity in relation to wartime trade requirements will be considered in appendices to this memorandum.