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FINANCIAL PROBLEMS OF THE EUROPEAN RECOVERY PROGRAM

Introductory Remarks

The European Recovery Program can be distinguished from other types of postwar assistance because of its main purpose - to bring about a balanced economy in Europe and throughout the world. It represents a unified approach to the over-all economic problems of Western Europe. American assistance under the program is intended to meet the costs of imports of goods and services essential to maximize production within the participating countries and to expand their trade among themselves and with the rest of the world. These long-range aims represent a great progress over relief measures and wasteful methods of attempting to deal with short-term problems of individual countries on a piecemeal basis. To these ends, self-help and mutual cooperation on the part of the European countries are the necessary counterparts to American assistance, and the United States has a right to expect that the very large sums of money made available by Congress will be used in the most effective possible manner.

The basic economic problem in Europe today is without doubt the problem of producing more goods. The physical damage and disorganization caused by the war, as well as the deterioration of equipment caused by wartime wear and neglect have not yet been entirely overcome. Furthermore, monetary and price dislocations arising out of the war have proved to be serious obstacles to recovery. Production cannot be restored to maximum levels unless adequate incentives exist both for business and labor, so as to ensure a regular flow of goods through the economy. Finally, wartime destruction in areas which previously had been important sources of supply for Europe have further hampered full production, and have made it necessary for European countries to rely more heavily than before on the Western Hemisphere for needed supplies.

This brings us to the problem of the balance of payments. Since few countries can produce for themselves all the kinds of goods they need, it is necessary for them to import certain things from outside, which they pay for, in effect, with surplus supplies of their own which are exported. If a country is not producing enough or cannot sell enough to pay for what it buys from outside, its balance of payments gets out of equilibrium. If a country cannot increase its production, it may have to reduce its consumption or its investment, to bring its balance of payments back to normal. Both of these alternatives, however, would be undesirable in most European countries today; any cuts from present consumption levels would reduce the productivity of the working population, while reducing the rate of investment would defeat the main object which is to restore and increase the country's productive capacity.

There are, of course, other reasons for the balance of payments problems of Europe today. One is the fact already mentioned that, due to the war, greater reliance has had to be placed on the United States and other Western Hemisphere countries for supplies. Thus, European countries have to redirect their trade so as to sell more to the Western Hemisphere, in order to be able to buy more. Another factor is the wartime loss or liquidation of large amounts of foreign investments, and the loss of a large part of European merchant shipping fleets, both of which facts have meant the loss of important sources of income which formerly helped pay for imports. Failing other means, countries might pay for their imports by using gold or foreign exchange resources accumulated in the past. Obviously, however, this can only be done for a limited time, and many European countries have been doing so for so long that their holdings are now reduced to extremely low levels.

Under these circumstances, the best solution appears to be assistance to Europe in the shape of loans or gifts over a temporary period, during which European countries could take the necessary steps to revive their own production and place their economies on a self-supporting basis. A program of four and a quarter years is contemplated for the purpose, and Congress has authorized approximately $5 billion of aid to Western Europe for the first year of the recovery program. This authorization was based upon careful and exhaustive studies by the technical staffs of the United States Government of essential European requirements and availabilities in the Western Hemisphere and elsewhere. It has been tentatively estimated that the total amount of aid needed over the entire period of the program might amount to $17 billion, but it is clear that estimates of requirements more than a year in advance must be very uncertain.

American assistance is not intended to enable European governments to continue practices of deficit spending and trade restrictions. The avoidance of inflationary practices in government budgets and the self-financing of internal costs of production and investments are regarded as prerequisite to the stabilization of currencies and the adoption of multilateralism in foreign trade. In this connection, the Administrator of the program has concluded agreements under which all recipient countries have undertaken very substantial obligations. These agreements embody the basic principles of the Charter of the International Trade Organization, which was adopted at Havana last March by 53 nations. Recipient countries agree to reduce trade barriers, to eliminate restrictive business practices, and to avoid arrangements restraining competition in international trade, limiting access to markets or fostering monopolistic control of natural resources. In particular, recipient countries agree to permit access to their natural resources by American investors and to put at the disposal of the United States scarce strategic materials in reasonable quantities and on reasonable terms. The financial problems involved in the European Recovery Program are examined in greater details in the following parts of the paper.

Local Currency Funds

Of special significance is the provision requiring recipient countries to set aside in a special account local currency in amount equivalent to the dollar value of goods and services received from the United States in the form of grants. These local currency funds are to be raised as part of the general government revenue and their uses are subject to approval by the Administrator of the program. In a number of cases the amount in question will be a very considerable portion of the country's total money supply. Thus, in these European countries the Administrator will be in a position to exercise a great constructive influence upon their financial situations. The use of these local currency funds is to be determined in accordance with the principles and aims of the European Recovery Program; namely, for retirement of currency or public debt as an anti-inflationary measure; for supplementing existing savings in new investments of productive character; for meeting certain government expenditures which would otherwise be financed in an inflationary way, and perhaps for financing net exports to other participating countries.

It must be noted that while the use of these local currency funds for debt retirement would usually have an automatic deflationary effect, this may be offset by contrary inflationary forces if expansionary measures (through private credit or budgetary deficits) were being taken at the same time. On the other hand, while expenditure of these funds on investment programs might ordinarily be expected to have an inflationary effect, yet conditions may arise under which the release of these funds for new investments would put to work available resources and manpower. In such cases the use of these funds would have no inflationary effect in the short run and would contribute to raise production and stabilize the economy in the long run. In other words it is the over-all financial and economic position of the country concerned that must be considered. If a country proposes to use its local currency funds for debt retirement, the U. S. Government would be concerned to ensure that the debt retirement is <u>effective</u> debt retirement.

In Italy, for example, lire deposits in the local currency account may amount this year to as much as one-third of the Italian Government's budget. The Italian Government might propose to use these funds for debt retirement. But when a country, as in Italy's case, is operating under a heavy budget deficit, it is not easy to see how any debt retirement carried out with the use of the local currency counterpart would be effective or "real". It is likely, therefore, that in most of the countries, an exception being the United Kingdom where there is a budget surplus, the local currency counterpart will be used to meet one or another sort of government expenditure. A country might ask permission, for example, to spend some of the local currency to subsidize milk production, or to subsidize flour millers so that bread might be maintained at an artificially low price as an anti-inflationary device. I do not wish to venture an opinion as to whether these would be appropriate uses to which to put the local currency counterpart, but I am sure you can see that some difficult policy decisions might be involved. Or, to take another example, a country such as France or Italy may wish to use considerable parts of the local currency counterpart for a general investment program--railways, port works, irrigation or reclamation, etc. Here the most important aspect of the decision may be to reach a judgment as to the general inflationary or deflationary situation in the spending country. We might feel that the country simply should not spend the additional amounts in view of already strong inflationary pressures; but the government of the country, for either political or economic reasons, might be very desirous of carrying out its program of investment.

It may also be added that not all countries are subject to the same degree of control through the deposit of local currency counterpart, as such deposits are required against grant assistance, but not against loan assistance. Probably if the economists could have been left free to draft exactly the kind of European Recovery Program which they wanted, they would have wished to provide the entire amount of aid on a grant basis, so as to avoid adding to the dollar debt of Europe during this difficult period of recovery. This would have preserved the dollar borrowing capacity of Western Europe to meet possible needs at the end of the European Recovery Program. Congress did not feel that it could go quite this far. But the Congressional Committee did ask the Government's witnesses whether they thought any part of the program could be arranged on a loan basis. The answer was that the amount which might be loaned would depend on the terms of the loans--that is, the rate of interest, the maturity, and the extent to which flexibility could be introduced to take account of fluctuations in the economic situation of the debtor countries in future years. The Congress finally provided that one billion dollars of the total amount of aid should be handled on a debt basis by the Administrator, i.e., he would borrow that amount from the Treasury and hence would loan that amount to ERP participants. This is about 20 per cent of the total. Moreover, as much as $300 million of this billion may be used to guarantee new investments of American enterprises in Western Europe, provided they are accepted by the Administrator and the recipient countries as part of the recovery program.

The Government experts have endeavored to work out loan-grant ratios country by country, which relate as accurately as can be determined to varying capacities of the ERP countries to incur additional dollar debt. As you may imagine, these ratios give rise to some touchy situations, since they result in some countries receiving all or nearly all of the aid in the form of grants while other countries receive all or nearly all of the aid in the form of loans. It has not been easy, moreover, to work out a sensible procedure for the handling of the loans. At first, it was tempting to explore the possibility of making a series of individual loans to each country for individual capital projects, such as power plants or refineries, with maturities and rates of interest possibly varying from project to project and country to country.

It has now become clear, however, that at least in the first year of the program it would be better to keep the terms of the loans substantially uniform as between foreign countries and, in effect, to set up general lines of credit. This having been done, it will be possible for the Export-Import Bank, as manager of the loan side of the Program, to work out arrangements so that these funds are used primarily for capital goods' projects. The ECA is at present negotiating with the ERP countries as to the terms of the loans and it is not possible to indicate how these negotiations are getting along. It is most important for the lending part of the Program to move along in pace with the grant portion of the Program. It is doubtful if Congress would be very happy to learn at the end of the first year that the Administrator had been quite successful in giving away $4 billion but had not been very successful in lending $1 billion. The European countries, it is believed, have come to appreciate this problem, although some of them did not seem to do so in the early months of the Program.

Financing Intra-European Trade

In a practical application of the principle of mutual cooperation among Western European countries, a possible use of the local currency funds might be for the purpose of financing intra-European trade. Since the end of the war the financing of such trade has been carried out largely through bilateral agreements, stipulating the kinds and amounts of goods to be traded and providing for the extension of reciprocal lines of credit. The restrictive nature of these agreements is obvious, as they tend to limit the volume of trade to the level of those countries which are least in a position to export. Moreover, the gradual exhaustion of the lines of credit has led creditor countries (such as Belgium) to insist on payments in gold or dollars for their surpluses or to balance trade on bilateral bases. Toward the latter part of 1947, this factor was apparently threatening a complete breakdown of intra-European trade. An attempt to solve this problem was made at that time, when a group of Western European countries agreed to set up a multilateral clearing system operated by the Bank for International Settlements. This mechanism proved to be workable, but its results were limited by the fact that settlement of intra-European balances could not be made automatic and universal. In fact, with few exceptions, most countries reserved the right to accept or reject propositions for compensations made by the Bank for International Settlements according to whether or not they considered such compensations desirable.

The European Recovery Program was designed primarily to meet the extraordinarily large deficit of Western Europe and the United Kingdom in its trade with the Western Hemisphere. At the same time, it was recognized that there are two other external deficits faced by the ERP countries: one with respect to other parts of the world outside of Western Europe, such as the Far East and Africa; the other arising within the ERP area, where a few countries (notably Belgium) are in a persistent creditor position with respect to the other participating countries. 1/ To a limited extent, both of these deficits might be eased were the ECA to carry on some "off-shore" procurement outside of the Western Hemisphere. For example, Pakistan jute or Belgian steel might be bought with dollars for delivery to France. In both cases, however, it would be reasonable to ask why Pakistan and Belgium could not themselves provide rupee or Belgian franc credits to France. The reply is that both of these creditor countries have their own dollar deficit problem with respect primarily to the Western Hemisphere. That is, both Belgium and Pakistan (illustrative of countries standing in a creditor position with other ERP countries) need dollars and, accordingly, tend to restrict credit to debtor ERP countries and even to divert their exports to countries willing and able to pay dollars. The result within the ERP area is an intensification of efforts at bilateral balancing which leads to forcing trade down to limits set by the current export capacity of the debtor.

The ERP countries have been struggling with this problem for almost a year and the plan which they have now put forward for consideration of the European and the United States Governments has the following main features: First: the ERP countries will work out some funding or "Standstill" arrangements for the debtor balances accumulated in the present Western European payments agreements. The creditor countries such as Belgium and the United Kingdom agree to set up adequate lines of credit in their own currencies with respect to their debtors in the ERP group.

1/ See Appendix

They also agree to work out as rapidly as possible some system of multilateral offset or clearing. Second: the ECA would agree that allocations of aid to the creditor countries in the ERP group would consist of two parts. One would be unconditional and the other, which would equal the estimated credit balance with ERP debtor countries in the subsequent period of time, would be conditional on the creditor country giving equivalent aid to its various debtors. The local currency counterpart could be used for this purpose. To illustrate, let us assume that the Paris Organization for European Economic Cooperation (OEEC) and the ECA have arrived at an estimate of $80 million as Belgium's need for dollars for a given quarter. Assume, also, that Belgium's debtors in the ERP area for the same quarter are going to need $40 million worth of Belgian franc credits or grants. The ECA would then make an unconditional allocation of $40 million and a conditional allocation of $40 million, the latter in consideration of equivalent aid to be given by Belgium to her debtors within the ERP area.

It is almost needless to remind you that these payments arrangements for Western Europe cannot lead to a permanent solution of the basic problem except insofar as the ERP area in the aggregate makes satisfactory progress toward genuine international equilibrium.

Exchange Rates and the International Monetary Fund

The ERP agreements contain clauses obligating the recipient countries to pursue orderly domestic economic and financial policies, by balancing the government budget, creating or maintaining internal financial stability, restoring confidence in the monetary system, stabilizing the currency and establishing or maintaining a valid rate of exchange. These agreements provide also for consultation with the United States on all matters, including, of course, exchange rates. Of course, it is not the desire of this Government to impose policies on other countries. Moreover, the Government has expressed its intention to make full use of the International Monetary Fund in dealing with exchange rate problems in connection with the European Recovery Program. At the same time, the United States reserves the right to initiate discussions respecting exchange rates.

The Articles of Agreement of the Fund require each member country to agree on a par value for its currency before it can obtain assistance from the Fund; they recognize, however, that such par values need not be permanent and provide a procedure for orderly changes through consultation with the Fund. Before beginning exchange transactions on March 1, 1947, the Fund approved the par values of thirty-two members 2/ and deferred determination in the case of nine members; subsequently it agreed on par values of seven other members 3/ (including five new members). At the time when these initial par values were established, both the Fund and the member countries recognized that the acceptance of such par values was tentative and that some of the rates would need modification from time to time.

The United States Government, through its interested agencies, gave careful consideration to the problem of initial parities and agreed with the Fund's view that par values established immediately after the end of the war could only be tentative. It recognized also that prevailing rates of exchange may in some instances be out of line with relative wage and price

2/ 3/ See Appendix

levels, and that some adjustments in exchange rates may prove necessary. There is general agreement that any action in Europe on exchange rates must be related to the steps taken toward internal stabilization of the economic and financial situations of the member countries. It is also clear that the United States has a direct interest in the maintenance of proper exchange rates in Europe as long as large scale dollar aid is being provided. Obviously, however, the adjustment of exchange rates cannot be made simultaneously for all countries, since the requisite degree of internal stability is attained at different periods.

Furthermore, the determination of what is a proper rate is by no means as simple as is often imagined.* Normally, a low exchange rate means more exports and less imports; a high rate means just the opposite. Even when this is true, of course, the inflationary effect of a devaluation may be worse than any temporary improvement which may have occurred in the balance of payments. But in some cases, a devaluation may not even have an appreciable effect on the balance of payments. If exports cannot be increased much due to production difficulties, and if imports were cut to the essential minimum anyway, the manipulation of exchange rates may not be beneficial. Moreover, even if it is believed that devaluation would be of advantage, the appropriate rate cannot be determined by simple price or purchasing power parity comparisons. This would be possible only if some base year could be selected in which a condition of perfect equilibrium had existed, and if in the interval since that year nothing had changed in the countries concerned except prices. There would remain difficulties of calculation even then, but it can be seen that the basic requirements are far from realistic.

Problems have already arisen in connection with the exchange rates of two important European countries, namely, Italy and France. At the time Italy was admitted to the Fund (March 1947) she had an exchange system based on multiple fluctuating rates and the Fund agreed to defer determination of the par value of the lira. Her exchange rate system had developed in this way: At the time of the Allied landing in Sicily in 1943 an exchange rate of 100 lire per U.S. dollar was established. In January 1946 this rate was de facto discontinued and a system of premiums and surcharges was introduced to make the effective rate for all transactions 225 lire per U.S. dollar. Beginning in March 1946 exporters were required to surrender to the Italian Foreign Exchange Office at this rate only fifty percent of their proceeds and were permitted to use the remaining fifty percent for their own authorized import needs or to dispose of it in a "free market" to importers of authorized commodities from free currency areas. It was this system which was in effect when Italy became a member of the Fund. On August 1, 1947, the premium of 125 percent was abolished and the official rate was changed from 100 to 350 per U.S. dollar; the average rate for exchange transactions continued to be determined on the basis of fifty percent at the official rate and fifty percent at the free market rate. In November 1947 Italy proposed to the Fund modifications in her exchange system, limiting spreads and fluctuations of rates. 4/ The Fund regarded this proposal as a step in the right direction, but could not give its approval because the new system was not made in accordance with the long-range objective of the

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* See International Monetary Fund "Third Annual Report" to be available 9/28/48

4/ See Appendix

Fund, the establishment of a single and stable exchange rate. Therefore, Italy is not entitled to draw on the Fund's resources.

In January 1948, the French Government proposed to change the par value of the franc, which had been agreed upon with the Fund at approximately 119 per dollar, and to modify the exchange system to include multiple and fluctuating rates. A new official rate of 214 francs per dollar (or the equivalent) was proposed for all currencies; but for the dollar (and the Portugese escudo, which is also a freely convertible currency) a "free market was established which actually was soon pegged at about 305 francs per dollar. Exporters to the dollar area could sell half their exchange at the free rate, which gave an effective export rate of 260 francs. The most essential imports from the dollar area were to enter at the 214 rate, but other imports would enter at the free rate. There was no intention to maintain cross rates in line with the new dollar rate. While the Fund recognized the special difficulties of France, it was unable to agree to a system which seemed unlikely to avoid uncertainty and instability in exchanges. Despite the Fund's objection, France put the system into effect. This action disqualified France from using the Fund's resources but did not require France to withdraw from membership.*

The United States Government has kept the Italian and French exchange system, as well as the exchange systems of other countries, under close and continual study. It believes that the pattern of exchange rates -- in Europe and elsewhere -- is by no means satisfactory for all countries, but is fully aware of the difficulties in establishing exchange rates which can be maintained by the member countries without undue recourse to the Fund under the circumstances prevailing in the world today.

The dollar resources of the International Monetary Fund as the result of a policy decision taken by the Fund last April are not available to countries participating in the European Recovery Program for the present, unless in exceptional and unforeseen cases. However, participating countries are free to draw one another's currency from the Fund. This decision is in line with the Fund's objective of maintaining its resources at a safe and reasonable level, and at the same time provides a means whereby European countries may help one another by lending through the Fund. Since April 20, 1948, the date of the Fund's policy decision above referred to, there have been no dollar drawings on the Fund by ERP countries. However, in this time, the Netherlands and Norway drew the equivalent of $6.8 million and $9.56 million, respectively, in Belgian francs. Total drawings on the Fund from the beginning of its operations to August 31 have amounted to the equivalent of $633.9 millions, of which $616.5 million was drawn in dollars. Of the $633.9 million - $558.1 million was drawn by present ERP countries, and of this $540.7 million was in dollars.5/

<u>The Problem of Western Germany--Special</u>

Before the war Germany played a vital role in the economy of Europe, both as a supplier and as a market for other European countries; hence the importance of Germany's reconstruction for the recovery of Europe as a whole.

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* See Fund's Third Annual Report to be released September 28, 1948

5/ See <u>Appendix</u>

In July 1948 industrial production in the US-UK zones reached 60 per cent of 1936, as compared to 42 per cent of 1936 in July 1947. As a result of the internal currency reform in the U.S.-U.K-French zones 6/ and the European Recovery Program, it is expected that a level of 70 per cent of 1936 probably will be reached in the near future. Even this ratio will be substantially lower than that attained by most other Western European countries. This lag justifies the expenditure of substantial ECA funds in addition to the large US-UK appropriations for the rehabilitation of the Western German economy.

The OEEC (Organization for European Economic Cooperation) which has been given the task of dividing ECA funds between the participating countries over the first year of ERP, has announced an allocation of $414 million for Bizonal Germany and $100 million for the French zone. The inflow of goods procured on the basis of these allocations is expected to raise the level of total imports in the second half of 1948 to almost $1 billion for the US-UK zones alone, or almost three times the figure of the second half of 1947. The sum corresponds in terms of real purchasing power approximately to the prewar level of imports. Exports of the US-UK zones, although also three times as large as in 1947, are expected to reach only about 40 per cent of imports and thus to remain still very much below the prewar level.

The currency reform was carried through in the US-UK-French zones of Germany in the period between June 18 and June 26. The reform ended the stage of "repressed inflation" which had hampered the Western German economy especially by diverting labor and capital to the black market and causing the hoarding of raw materials and finished products. In consequence of the restoration of the value of money, price control and rationing could be lifted for all but the most important commodities.

It is proposed to alleviate the scarcity of credit due to the currency reform by use of the local currency receipts for the sale of goods imported under ECA and US-UK appropriations. As indicated, these receipts are to be deposited in special accounts and it is proposed that these sums be used for establishing a reconstruction bank that will grant productive credits to the Western German economy.

Originally, the currency reform did not extend to Berlin, but the attempt of the Soviet authorities to force the currency circulating in the Soviet zone of Germany upon the Western sectors of Berlin without quadripartite action, forced the Western powers to introduce the currency of the Western zones in their sectors. The problem of unifying the Berlin currency system is still under quadripartite consideration.

The Role of the National Advisory Council

Cooperation on financial matters pertaining to the European Recovery Program is required among the various departments and agencies of the United States Government concerned with foreign financial activities. The medium for such coordination is the National Advisory Council on International Monetary and Financial Problems, which was created by Congress in 1945 under Section 4 of the Bretton Woods Agreement Act. The Council consists of the Secretary of the Treasury, the Secretary of State, the Secretary of Commerce, the Chairman of the Board of Governors

6/ See Appendix

of the Federal Reserve System, the Chairman of the Board of Trustees of the Export-Import Bank, and, now, also the Administrator of the European Recovery Program.*

Since its creation, the Council has played an active part in the determination of the foreign financial policy of the United States and in insuring consistency of action on the part of all Government agencies dealing with foreign financial matters. In particular, the Council has maintained constant consultations with the United States Directors of the International Monetary Fund and the International Bank, and has given advice to the Administrator of the European Recovery Program on matters of local currency funds, loan-grant ratios, and all other financial aspects of the program. It has been a primary concern of the Council to make certain that the domestic and international policies of the United States are effectively coordinated in a manner designed not only to insure the attainment of our foreign objectives, but to insure also that our actions in this field do not threaten the stability of our economic system.

The American Economy and Foreign Aid

It must be recognized that our foreign economic program in the aggregate imposes a very real burden upon the United States--a financial burden upon our Federal budget and an economic burden upon our people who are called upon to export to foreign countries far more goods and services than they receive in exchange. The European Recovery Program is the most important, though not the sole item of our foreign aid. Other Congressional appropriations have provided assistance to areas occupied by United States forces, such as Germany and Japan, and to other countries such as China, Greece, and the Philippines, while the Export-Import Bank 7/ and the International Bank for Reconstruction and Development 8/ (the latter thus far making little except dollar loans) continue to finance sound economic projects in Europe, Latin America, and other parts of the world. The predominant character of the European Recovery Program may be gauged by the fact that the amount authorized and appropriated on its account--$5 billion--represents about four-fifths of the total appropriations by Congress for foreign aid for the current fiscal year. 9/ Because of the large dependence of Europe on world trade, the role of the European Recovery Program goes far beyond any geographical limitations--in fact, it is intended that a substantial part of the dollars made available to European countries will be spent in Canada, Latin America, and countries outside the Western Hemisphere. In this way our aid to Europe will also serve to provide Canada and Latin America with dollars, which they in turn can use to pay for goods they need from this country, and will help to alleviate balance of payments problems in a wide area.

The Administration's recommendations on foreign aid were decided upon in the light of careful and comprehensive studies of our capacity to bear this burden. These studies were undertaken in the second half of 1947, at a time when taxation remained at wartime levels and defense expenditures were declining. The general conclusions were that the amount of foreign aid contemplated for the current year would not impose any greater drain upon

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* and/or their alternates.
7/, 8/, 9/ See Appendix

American resources than occurred during past years, and that this drain would not unduly affect the standard of living of the American people and the stability of the American economy. These conclusions were based on certain assumptions, mainly that there would be no overall increase in Government expenditures or decrease in taxation, and that the inflationary impact would be held in check by appropriate domestic measures. The most important of these domestic measures is in the realm of budgetary policies; it is supremely important that Government expenditures, including those on foreign aid and national defense, be covered within a balanced budget. If this practice is followed, the purchasing power created by these expenditures will be withdrawn from the market through taxation. At the same time, in view of the inflationary pressure arising from domestic as well as foreign sources it is important to carry out a monetary policy designed to restrain the expansion of bank credit. To achieve the proper combination of budgetary and monetary policies requires the close cooperation of the United States Treasury and the Federal Reserve System. This I shall develop further this evening--in the Seminar discussion.

The cost of the foreign economic program as a whole represents a substantial measure of genuine sacrifice and subjects the American people to further inflationary pressures on the domestic economy in the short run in order to contribute to international security and economic stabilization in the long run. The cost of foreign aid seems to be small indeed compared to the cost of the alternative. If we should refuse to extend assistance to foreign countries in critical need, we would run the risk of precipitating foreign developments of the most sinister character. We would be confronted with revolutionary economic and political changes throughout the world. All hope of a democratic international order would be gone. War-wrecked countries in Europe and the Far East, deprived of the hope of a return to tolerable living standards, would become the easy prey of regimes which promise economic security in exchange for the surrender of political freedom. Confronted with the world largely made up of dictatorships of the left or right, the United States would find itself isolated in a cold and hostile world. To maintain even a pretense of security under these conditions would require a level of expenditures for defense vastly greater than any now contemplated. The present and prospective sums spent for foreign aid should be measured against these alternatives.

Conclusion

It is premature to attempt any quantitative estimate of the progress toward domestic recovery and international equilibrium which is being made by the European Recovery Program countries. The Administrator and other Government officials are very keenly aware that the Congress will expect a full statement at the time a request is made for an appropriation to cover the second year. But the ECA did not come into existence until the first part of April and in the five intervening months a certain amount of time inevitably has had to be spent on getting started. According to the latest available figures, as of September 3, 1948, ECA procurement authorizations 10/ for Europe have reached a total of $1,369 million but, of course, by no means all of this amount of aid has

10/ See Appendix

yet actually reached Europe in the form of food, materials, and equipment.

There is, of course, no certainty that our foreign recovery program will achieve all that we hope for it. Difficulties at present unforeseen may arise to disappoint and thwart us, but such possibilities should not blind us to the certainty of disaster if we shrink from the task. In this connection, there is grave danger that we shall set too much store by the results achieved in the first year and, if these results are disappointing, take the short-sighted step of discontinuing or greatly curtailing the program. In fact, the objectives sought by the program cannot possibly be achieved in one year. To expect more than a sound beginning of the desired recovery would be to misunderstand the nature of the problem and of the remedy. It should be remembered that after the first World War, which was vastly less destructive and disruptive than the recent conflict, it was not until 1925, or seven years after the defeat of Germany, that European economic activity was restored to the pre-war level.

To a very large degree, the success of our foreign economic program will depend upon our own future actions. This applies not only to our actions directly relating to the program itself but to our decisions in the broader field of economic policy as a whole. For example, we cannot expect either the recovery of world trade or the recovery of Europe if, after a short breathing spell, we attempt to re-instate prohibitive tariffs and thereby prevent Europe from selling the exports it must sell if it is to pay for the imports it needs and thus become self-supporting again. For Europe to pay its way, it is not enough that European countries are able to produce the necessary volume of exports; they must also be able to sell them. This means that other countries, including our own country, must be prepared to increase imports.

In the second place, we cannot expect Europe to achieve economic and political stability if our own economy, which is such an important segment of the world economy, is characterized by severe booms and depressions accompanied by equally drastic fluctuations in our purchases from abroad. Much depends on our ability to keep our own house in order - particularly on our ability to avoid the evils of inflation and deflation. Inflation is the immediate problem, and this we must fight at the source, which means maintaining maximum production and restraining as well as reducing excess purchasing power.

To a degree which is almost impossible to exaggerate, the future depends on the type of leadership shown by this country. Of the major countries which were engaged in the recent conflict, our country was almost alone in being able to keep its productive capacity intact. It has been estimated that the United States at present accounts for roughly half of the world's industrial production. Thus, without asking for the role, we find ourselves catapulted into a position of great power and influence which carries with it a great responsibility, both abroad and at home.

Appendix - Footnotes

1. In 1947, Belgium had a favorable trade balance with respect to the other participating countries of $99 million. However, including invisible items (shipping, tourism, interest and dividends, etc.) as well as trade, Belgium's favorable balance with participating countries on current account amounted to only $81 million. Net credits for the third quarter of 1948 are estimated at $28 million. Belgium's over-all trade deficit with the world as a whole, however, has been estimated at $441 million and her deficit with the United States at $476 million.

2. Par values announced by international Monetary Fund, December 18, 1946:

Country	Par Value (¢ per unit of foreign currency)	(local currency units per dollar)	Comments
Belgium	2.28	43.83	
Bolivia	2.38	42.00	
Canada	100.00	1.00	
Chile	3.23	31.00	
Colombia	57.14	1.75	
Costa Rica	17.81	5.62	
Cuba	100.00	1.00	
Czechoslovakia	2.00	50.00	
Denmark	20.84	4.80	
Ecuador	7.41	13.50	
Egypt	413.30	.24	
El Salvador	40.00	2.50	
Ethiopia	40.25	2.48	
France	.84	119.11	/There has been no agreed par value for the Franc since France instituted its new exchange system on January 26, 1948/
Guatamala	100.00	1.00	
Honduras	50.00	2.00	
Iceland	15.41	6.49	
India	30.23	3.31	
Iran	3.10	32.25	
Iraq	403.00	.25	
Luxembourg	2.28	43.83	
Mexico	20.60	4.86	
Netherlands	37.70	2.65	
Nicaragua	20.00	5.00	
Norway	20.15	4.96	
Panama	100.00	1.00	
Paraguay	32.36	3.09	
Peru	15.38	6.50	
Philippines	50.00	2.00	

Country	Par Value		Comments
South Africa	403.00	.25	
United Kingdom	403.00	.25	
United States	100.00	1.00	

3. Par Values announced by International Monetary Fund subsequently:

Country	Par Value ($\cancel{c}$ per unit of foreign currency)	(local currency units per dollar)	Comments
Australia	322.40	.31	New member; par announced 11-17-47
Brazil	5.41	18.50	Par announced 7-14-48
Dominican Republic	100.00	1.00	Par announced 4-23-48
Lebanon	45.63	2.19	New member; par announced 7-29-47
Syria	45.63	2.19	New member; par announced 7-29-47
Turkey	35.71	2.80	New member; par announced 6-19-47
Venezuela	29.85	3.35	Par announced 4-18-47

4. The Italian system of exchange rates which was established then, and which is presently applied, is as follows:

The official "fixed" rate of 350 lire per U. S. dollar was replaced by a fluctuating rate determined monthly on the basis of the free market quotations of the previous month. The old rate of 350 lire per dollar was discontinued for current exchange transactions, although it has been retained for certain internal valuations and for determining rates applicable to certain payment agreements. Current transactions are conducted at the following rates of exchange: (1) An official rate determined each month by the average of the rates prevailing in the free market during the preceding month; this average is limited to quotations within a range of 350 lire to 650 lire per U. S. dollar. Fifty per cent of exchange proceeds from free currency areas are sold at this rate to the Italian Foreign Exchange Office, while on the selling side exchange is supplied at this rate for certain governmental imports and for imports under all payment agreements; (2) A free market rate at which the remaining fifty per cent of exchange proceeds from free currency areas is sold. All non-governmental imports from free currency areas are made at this rate; (3) The average of the above two rates, which is the effective rate for all exchange proceeds from free currency areas.

The exchange rates of the lira per U. S. dollar have remained very stable throughout the first part of the year, as indicated by the following quotations reported by the International Monetary Fund:

Exchange Rates (lire per U.S. dollar)	Jan.	Feb.	March	April	May	June	July
(1) Official	576	573	573	574	575	575	575
(2) Free	573	573	574	575	575	575	575
(3) Average	574	573	574	574	575	575	575

5. Total drawings on the Fund to July 31, 1948, by country are as follows:

ERP Countries	Quota	Drawings		
	(In millions of U.S. dollars)			
		In U.S. dollars	Other	Total
Belgium	225	33.0	--	33.0
Denmark	68	10.2	--	10.2
France	525	125.0	--	125.0
Netherlands	275	62.5	(6 a/ (6.8 b/	75.3
Norway	50	5.0	4.6 c/	9.6
Turkey	43	5.0	--	5.0
United Kingdom	1,300	300.0	--	300.0
		540.7		558.1

a/ Dollar equivalent of purchase of sterling
b/ Dollar equivalent of purchase of Belgian francs
c/ Dollar equivalent of purchase of Belgian francs

Other than ERP countries				
Chile	50	8.8	--	8.8
Ethiopia	6	.3	--	.3
India	400	44.2	--	44.2
Mexico	90	22.5	--	22.5
		75.8		75.8

6. The reichsmark currency in Western Germany was converted into the new "Deutsche Mark" at the rate of 1 new for 10 old marks. Only 60 new marks were paid out in cash, however, (40 marks immediately and 20 marks on August 20); the remainder had to be deposited in bank accounts, of which one-half was temporarily blocked. All accounts exceeding 5,000 old marks were released only after investigation of the owner's tax status. Holdings of public agencies were not converted, but public agencies (including the occupation authorities) received amounts sufficient to provide for one month's operations. The German authorities were instructed to enact legislation and impose special levies for the equalization of the burdens imposed by the currency conversion.

No official exchange rate has as yet been established for the new currency, but in foreign trade (with the exception of food imports) a factor of 30 cents per mark is used for the conversion of dollar payments and proceeds into German currency.

7. As of July 31, 1948, the Export-Import Bank had outstanding loans amounting to $2,224 millions, and undisbursed authorizations of $616 millions. This, out of a total lending authority of $3500 millions, left $660 millions of uncommitted lending authority.

8. The following table shows loans extended by the International Bank as of June 30, 1948:

	Loans authorized	Disburse- ments	Unused balance of commitment
	(Millions of U.S. dollars)		
France	250	250	
Netherlands	195	195	
Netherlands shipping companies*	12	12	
Denmark	40	16.4	23.6
Luxembourg	12	8.6	3.4
Chile	16	0	16

* $8.1 million of this loan was extended by 10 U. S. commercial banks and guaranteed by the International Bank.

(For further information on International Bank operations see Third Annual Report to be released September 29, 1948.)

9. The amounts appropriated or authorized by Congress for foreign aid for the fiscal year 1948-49 are as follows:

	(In millions of dollars)	
European Recovery Program	$ 5,055	a/
Government & Relief in Occupied Areas b/	1,300	
Revolving fund for purchase of agricultural commodities for occupied areas	150	c/
Greek-Turkish Aid	275	
China Aid	400	d/
Philippine Rehabilitation	116	
International Refugee Organization	71	
International Childrens Emergency Fund	35	

a/ $4,000 million appropriated for use from April 3, 1948, to June 30, 1949, but may be spent in period ending April 2, 1949. $55 million represents a deficiency appropriation for fiscal 1948. $1,000 million represents authorization to the Economic Cooperation Administration for extension of credits through the Export-Import Bank.

b/ For Germany, Japan, Korea, the Ryuku Islands, and a small sum for occupation costs in Austria.

c/ Credit authorization

d/ Available to April 2, 1949

10. Procurement authorizations are issued at the request of the European countries, in accordance with the fund allocations made by ECA at the beginning of each quarter to each recipient country. Total fund allocations by ECA to ERP countries for the period April 3 to September 30, 1948, amount to $2,595 million, of which $2,080 is in the form of grants, and $515 in the form of loans. The ECA has so far extended only one loan, to Iceland ($2.3 million). Loan negotiations with other ERP countries (U.K., France, Belgium, Italy, etc.) are in course and will be concluded shortly. It is quite possible that procurement authorizations will reach by September 30 a figure close to that of grant allocations ($2,080 million). Procurement authorizations on loan on the other hand, will not begin until after the signing of the loan agreements and, therefore, the total amount outstanding at the end of September - if any - will possibly be small.