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Leonard B. Rist - Information Conferences - Speeches - 1949 - 1950

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ECO. DEVELOPMENT

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March 29, 1951  
h B Rist  
Conference

1. Historical Introduction

Looking back over the economic and financial history of the postwar years, perhaps the most striking single phenomenon which one encounters in the five-year perspective is the extent to which the economic dislocation which the war had brought about had been underestimated. When the International Bank was established in 1945, it was generally accepted that the Bank's resources, together with those of UNRRA and the United States Treasury loan to Great Britain, would provide a sufficient volume of resources to replenish the productive facilities of the industrial countries and to eradicate the economic consequences of war and hostile occupation in the other parts of the world. We also assumed that the trade restrictions and exchange controls which had been imposed in the depression years of the 30's and applied more or less generally in Europe and elsewhere in the course of the war, would disappear fairly rapidly and that we could look forward to a period of unimpeded multilateral trade on a non-discriminatory basis, unhampered by exchange restrictions and sustained by a flow of long-term capital.

We know now that this appraisal of the postwar prospects was far too optimistic. The physical destruction and breakdown of the normal channels of commercial relations turned out to be more severe than had been anticipated.



The winter crisis of 1946-47 showed for the first time how shaky the foundations of the economic recovery of Western Europe actually were. It was followed by a series of crises which culminated in the official recognition that the reserves of the sterling area could not stand the strains imposed upon them by the convertibility stipulations of the Anglo-American Loan Agreement.

## 2. The Marshall Plan

After some preliminary measures to provide what has been properly called "stop gap" aid, it was recognized by the American Government that nothing short of an overall program of several years duration would provide sufficient aid and allow sufficient time to Western Europe and the sterling area to re-constitute their economies and to re-build their economic vitality. In the spring of 1948, the Marshall Plan was begun with the avowed purpose of recreating those conditions under which the economically advanced countries of the world could enjoy again the advantages of free economic intercourse and the less developed countries of the world could derive their rightful share of the benefits of economic progress.

There cannot be any question that the Marshall Plan has been successful beyond all expectations. The \$11 billion, which the American Government has provided for the economic recovery of Western Europe, have brought results which

must be valued at a multiple of the amounts expended: in all countries of Western Europe the volume of industrial production is substantially above that of the prewar years; industrial capacity is larger and more modern than ever before; standards of living have been brought back to prewar levels; and the volume of investment, both on private and government account, holds promise for a vigorous further growth in the years ahead.

### 3. The Dollar Gap

The volume of United States aid to the rest of the world was reflected in a large export surplus of goods and services in the American balance of payments; the success of the Marshall Plan, on the other hand, was reflected in a constant decline of this surplus without a commensurate decline in the volume of consumption and investment in the recipient countries and in third areas. In the course of 1949 it became apparent, however, that the external financial position of most European countries, but particularly of the United Kingdom, had not improved pari-passu with the internal recovery of their economies. In consequence - and as a final attempt to re-establish external balance between Western Europe and the rest of the world and particularly with the dollar area - the currencies of Western Europe were drastically devalued vis-a-vis the dollar.

~~An analysis of the development in the period between the devaluations~~



4. The Developments in 1950

Turning now to the economic developments of the last few months, we must of course realize that they are not only over-shadowed but also largely determined by political events. The outbreak of hostilities in Korea and the subsequent decision to strengthen the defense of the North Atlantic Treaty countries did not, however, cause as radical departure from basic trends as it may appear at first glance. They merely accentuated, and in a certain way perhaps over-accentuated those trends which had become apparent in the last months prior to Korea.

In the period between the devaluations and the outbreak of the war in Korea, an expansion of economic activity throughout the world and the strong tendencies toward a position of balance between foreign countries and the United States had become noticeable. In the United States a high level of employment and economic activity was sustained by a large volume of investment both in plant and equipment of industrial enterprises and in residential construction. In Western Europe restrictions, which threatened to impede the free flow of trade within Europe, were overcome through the concerted efforts of the ERP countries working together in the Organization for European Economic Cooperation.

Their joint efforts culminated in the establishment of the European Payments Union and in agreements to curtail quantitative import restrictions within Western Europe.

The raw material and foodstuff producing countries in Latin America, Asia and Africa benefited greatly from the general expansion of economic activity in the industrial countries. Contrary to the expectations of some quarters, ~~the devaluation of European currencies did not result in the decline in the dol-~~ *(did not decline after the devaluation of European currencies)* lar prices of most raw materials and foodstuffs. ~~To the contrary,~~ *but not only that* the commodity markets recorded substantial gains in the course of the nine month period between the devaluation and Korea.

##### 5. The Impact of Korea

The reaction of the United States and of the countries of Western Europe to the outbreak of hostilities in Korea merely lent additional impetus to the developments of the preceding months. In the United States consumers' expenditures expanded rapidly in anticipation of shortages necessitated by armaments production. The expansion of consumer purchases in turn caused increased production and expanded incomes. In the last quarter of 1950 government expenditures began to rise at a rapid rate. The reaction of Western Europe



to the changing political situation, although less drastic than that in the United States, moved generally in the same direction.

The overall result of increased production in virtually all countries to the limits of industrial capacity and of the simultaneous attempts to accumulate stocks of raw materials for military and civilian supply purposes was the further rapid increase in the prices of the main export commodities of underdeveloped countries. These price increases, together with the expansion of the volume of imports, brought about drastic changes in the international accounts of the United States. The balance of payments statistics indicate that the current account surplus of the United States has almost disappeared. For the second half of 1950 it amounted to not more than \$700 million; it was more than offset by public and private gifts of \$2.2 billion. If these overall figures are broken down into their regional components, it appears, however, that Western Europe still has a deficit on current account with the United States of approximately \$1.8 billion per annum, while third areas are running in the aggregate a current account surplus of approximately \$600 million. This seems to indicate that the residual dollar deficit of the Western European countries could be virtually eliminated if they could earn dollars in third areas. However, monetary statistics

indicate that for the present the dollar surplus countries seem to prefer to increase their gold and dollar reserves rather than increase their dollar expenditures in Europe.

Moreover, there are several reasons which strongly suggest that the overall balance in the international accounts of the United States with the rest of the world must be considered a temporary phenomena rather than the result of structural and lasting adjustments. In the first place a certain proportion of the dollar gains of the raw material and food-producing countries of the sterling area and elsewhere must be attributed to price increased of such commodities as rubber, tin and wool which can only be characterized as abnormal. In the course of the next few months the prices of American exports are likely to gradually come closer to the price level of imported raw materials; raw material prices in turn may recede somewhat - in some instances they have already done so - in response to the international allocation schemes which are under active consideration by the American, British and French Governments.

Moreover, the expansion of industrial production, particularly for armament purposes, has progressed more rapidly in the United States than in Western Europe. Once armaments production gets under way on a large scale in



Western Europe, the import requirements both for military and civilian purposes of these countries are bound to increase, while the availability of goods for export may become limited. The budget message of the President of the United States indicates the intention of the administration to provide sufficient aid to the North Atlantic Treaty countries to prevent the re-appearance of serious balance of payments difficulties. But in addition to the promised volume of military and economic aid, it will take hard fiscal and monetary policies to counteract the inflationary pressures created by defense expenditures and to control the balance of payments pressures which inflationary forces generate.

6. The Effects of Postwar Developments on the Bank's Operations

The "economic history" of the postwar period, which I just traced, was of course the primary determining factor for the operations of the International Bank. The first three loans which the Bank made all went to European countries (France, Denmark and Netherlands) to aid in the reconstruction and industrial rehabilitation of their economies. They were general purpose loans designed to provide dollar funds for the purchase of equipment and raw materials needed in the task of physical reconstruction.

After the Marshall Plan had started, the Bank focused attention on

loan requests of countries in Latin America, the Far East and the Middle East. In view of the prevailing conditions of inconvertibility of almost all currencies into dollars, and because the United States was practically the only country in which the goods needed for development purposes were available, the Bank was in virtually all instances faced with the problem of determining the creditworthiness of the loan applicants on the basis of their bilateral relations with the United States. It is quite clear that no other course of action was feasible at a time when the gold and dollar reserves of most countries were declining and when the prospects of earning convertible currencies in third areas appeared remote.

As a result of the quite drastic changes which have taken place since the devaluations of September 1949, and particularly in the course of the <sup>nine</sup>~~six~~ months since the outbreak of the Korean war, and in view of the likelihood that military requirements and civilian demands will assure markets for all commodities, which underdeveloped countries produce, the outlook for an expansion of the Bank's lending activities from the point of view of the creditworthiness of loan applicants has brightened considerably. In the course of the last <sup>nine</sup>~~six~~ months, the gold and dollar reserves of the sterling area has <sup>ve</sup> increased by another <sup>\$1350</sup>~~\$900~~



million to \$3,<sup>7</sup>/<sub>8</sub> billion, compared with \$1.4 billion at the time of the devaluation. Moreover, the prospects are that ~~even taking account of the termination of Marshall aid to Great Britain,~~ further increases - although perhaps at a reduced rate - will take place. From the point of view of the Bank that means that it appears reasonable to modify the appraisal of the creditworthiness of many of the overseas member countries of the sterling area by assuming that in the case of necessity these countries can count on the reserve pool for such amounts of dollars as may be needed to discharge their interest and amortization obligations on Bank loans. This is not to say that we shall base our appraisal of the creditworthiness of these countries on the assumption of full convertibility of sterling; for our purposes it is sufficient to be reasonably assured that the borrowing countries will have access to the dollar pool of the sterling area in the event that their own dollar earnings are temporarily insufficient to discharge their obligations under loan agreements.

The situation is similar in the case of many Latin American countries. Increased foreign dollar earnings have enabled them to achieve a balance between their hard currency earnings and expenditures and, beyond that, to strengthen their international reserves. Their prospects of a continued balance between foreign receipts and expenditures are good - in most cases, very good. Therefore,

their creditworthiness is unquestionably better today than at any time since the end of the war.

Two other developments are of sufficient significance to deserve some comment. One is the fact that as a result of the increase in European production, together with the announced intention of pooling the industrial resources of the North Atlantic Treaty countries, and the impact of the armaments efforts in the United States, it is quite possible that the supply of industrial equipment from European sources may be for some time more abundant, or, at least, less tight than that from this country. In consequence, it may be possible that the International Bank could gradually rely more heavily upon the use of its own, or of borrowed, funds of European currencies for loans to overseas countries. It would, of course, be wrong to expect that more than a relatively small fraction of our total lending will consist of loans in non-dollar currencies; but it may be possible to make sound loans in European currencies to some member countries whose prospects of dollar earnings do not appear sufficient to permit a satisfactory appraisal of their creditworthiness for a dollar loan, but which may earn sufficient amounts of soft currencies to make them eligible for non-dollar loans. In practice, a combination of dollar and non-dollar loans, which would bring down



the dollar debt burden of borrowers, may perhaps become more important; such a combination would in certain circumstances make both the dollar and the non-dollar loans sounder business propositions.

The other factor which is bound to affect the lending operations of the Bank are the shortages of certain types of equipment which are developing in ~~certain~~<sup>some</sup> sectors of the American economy. In some quarters it has been suggested that the limited availability of capital goods may necessitate a curtailment of the lending operations of the Bank, or, more generally, of movements of long-term capital from the United States. We have of course paid close attention to this problem in recent months and we find that the overall picture is far less disturbing than first impressions may indicate.

There are several reasons which make me believe that the loan operations of the Bank can continue on a substantial and perhaps on an expanded scale. In the first place we have the assurance from various pronouncements of the President of the United States and high government officials that the government considers financial assistance to underdeveloped countries a major aim of American foreign economic policy which is not conflicting with, but complementary to the primary objective of strengthening the defense of the Western Powers. In all our lending operations we have paid close attention to the soundness of

the loan projects and to the direct and indirect contributions which each project makes to the strengthening of the economies of our borrowers. Our loan agreements themselves can therefore be taken as prima facie evidence that the projects and programs which we finance are fully in line with the foreign economic policy objectives of the United States.

Secondly, we have found in our investigations that exports of capital goods which are likely to be in short supply in this country amount to a very small fraction - on the average not more than 3 to 4% - of the American production of these goods. I believe that we are therefore justified in our hope that the borrowers will be able to count on that volume of scarce supplies which is absolutely essential from a technical point of view for the carrying out of the projects which we finance.

Thirdly, we will obviously take account of the supply situation in the composition of development programs and in the selection of loan projects. In most instances it should be possible to modify our loan operations in such a way as to keep the demand for scarce items to a minimum. As long as the development programs which we finance are sound from an economic and engineering point of view, their implementation can always be modified in order to take account of the overriding needs for military purposes.



Finally, there is of course the probability which I mentioned before that capital goods may be more freely available in certain European countries than in the United States. The fact that we are the only public lending institution whose funds can be disbursed anywhere and particularly in those countries where disbursements will conflict least with armament requirements gives us additional assurance that we will be able to continue to be active in providing financial assistance for the economic development of our member countries.

~~Perhaps~~ There does not seem to be any essential difference between the process of expansion in a developed country and the process of development. except that the framework ~~wherein~~ where both take place is by definition <sup>very</sup> different. Much lower income per head <sup>means</sup> ~~more~~ savings more difficult, education less widespread, <sup>consumers market with smaller</sup> manpower less productive, and also <sup>very</sup> often quickly increasing population, and a fluid future.

The definition of the future cannot hardly be expressed in words or statistics. Complete state planning and target fixing is quite exceptional <sup>and even then is subject to abrupt change</sup>. But some trend or direction ~~is distinguishable~~ can usually be determined a) from the type of investment undertaken in the public sector. b) from the type of investment which goes on in the free sector. usually unprotected (if not always unprotected)



April 24, 1950

ECONOMIC DEVELOPMENT

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We thought that, without giving you a complete philosophy of economic development, we could give you some idea of the problems which we have been and still are considering in relation to it. Mr. Burke Knapp will speak to you of the channels of ~~varied aspects~~ of international movements of capital in relation to development. Mr. Harold Larsen will speak of some aspects of the domestic capital formation and its limitations, financial and real.

For my part, I would like to indicate one or two basic difficulties we have met in ~~our~~ operations. These difficulties are not only practical, they are theoretical as well. While we cannot contend that we have found a complete or definitive answer to them, we could at least show you in what direction our minds have worked.

The first difficulty is involved in the determination of priority investment. Given a certain capacity of absorption, given a certain amount of available financing, assuming what is almost inevitable that all the financing desired is not available, which project should be selected?

While there are about as many patterns of development



as there are countries, some features are fairly common among them. 1) I do not know of any country where development is not proceeding - with or without foreign assistance. It is a continuous process which is based on implicit or explicit views as to the future structure of the economy concerned. The request for international assistance arises from the desire to stimulate or accelerate the process, not from the idea that movement must be substituted for complete stagnation. 2) The second common feature is that, outside very definite exceptions such as Eastern Europe, complete State planning and control does not exist and private investment therefore proceeds on lines which are more or less independent from government action, except <sup>perhaps for tariff protection</sup> ~~perhaps for tariff protection~~. 3) Thirdly, this private investment usually constitutes a major fraction of total capital formation. It is directly prompted by market expectations and stands in an underdeveloped country roughly as good a chance of being profitable as in other surroundings. 4) Fourthly, however, even if private initiative feels a spontaneous and healthy urge to invest, the State in any case has either to support this spontaneous urge, or to provide some relatively unproductive investments - the so-called social overhead capital or both. The State and ourselves to the same extent, therefore must have a view of the direction in which the economy is developing, lest investment be misdirected. Capital waste in a country <sup>where</sup> ~~which~~ by definition is scarce <sup>capital</sup> ~~of capital~~ is a great danger.

The complexity of the problem arises from the fact



that simple bottlenecks are a rare occurrence. In the case of Salvador, lack of power clearly held <sup>down</sup> a number of potential initiatives ~~down~~. Electricity would in any case be very useful. But most economies are more complex. Releasing some bottlenecks may be little help if others are not taken care of at the same time. It is therefore less the immediate effect of one single project, but the aggregate effect of the general investment movement which must be appraised.

Until now in the practical cases which we had to deal with, our assistance has gone to fields which we could securely consider as first priorities, or rather - to use my own correction - as being among the first priorities. Social overhead capital such as power and transportation, or when the justified policy of the government was "grow more food", agricultural implements and ground clearing equipment, or storage. But always we had to consider whether other pressing needs were not being neglected in the overall investment program which was going on at the same time. Balanced development would ~~no more~~ ~~not~~ take place if power were provided without the roads and the equipment <sup>may</sup> ~~and~~ if manpower were not available to till the fields or man the factories.

*Integration*

The governments, we found, are becoming more and more aware of this problem of priorities or "of equal precedence", <sup>or if you prefer of integration</sup> but in each country, they have to be reviewed continuously to take account of changes in demand or of

changing/



In order to circumscribe the discussion  
~~we~~ must assume two points.

a) that when we talk of development we  
actually mean expansion of production in  
a low income community.

b) We are concerned only with countries  
who are not in a position or are not  
inclined to achieve the shift in resources  
implied by developmental investment at  
much sacrifice to their local consumption  
In other words by definition they expect  
to ~~not~~



changing conditions in different areas. One special aspect of priorities may be noted incidentally. The problem will become more and more difficult as we are more intimately acquainted with certain countries and as our assistance is sought for private industry as well as State sponsored operations. A choice between capital intensive and labor intensive industries may be involved and this will in each case require a special decision.

The second major difficulty we have to contend with is the relationship between balance of payment and increased productivity and national income. We are all agreed that the main purpose of development is to increase both production and productivity to the point where national income grows quicker than the population, in other words to the point where national income per head begins to grow. <sup>But</sup> Theoretically this can take place without any improvement in the balance of payment of the country. An increase in money income alone, even if this inflation is for the purpose of investing has, as a rule, an unfavourable effect on the balance of payments. But an increase in real income - though non inflationary - may improve the standard of living without improving the balance of payments, i.e. without giving the countries a surplus of resources which may be exchanged for foreign equipment, or without involving the expectation that an improvement will take place and thus attracting credits with fairly reasonable hopes of repayments.

In other words, <sup>since</sup> when we lend we expect to receive

*Theoretically  
can be done  
without relation  
with debt  
as loans - shift  
on amount  
different*



repayment, the prospective balance of payments of the country is the only basis on which such expectations can be calculated. Not each individual project, but the aggregate development investment going on in the country should be of such a nature that either it will not disturb the present balance or that it will improve it at least as much as is necessary to carry an additional fixed burden in foreign currency. If this is true of the Bank, this is true also of all foreign investors. Here also the concept of balanced development is necessary. It refers not only to the need for a proper choice of investments to be undertaken by priority or parallel to each other for the purpose of increasing productivity and the standard of living. It refers also to the effects of such investments on the international position of the country. It is not enough that the investment be urgent, if carrying it out means inflation and the maldistribution of income and investment which is its counterpart as well as excessive pressure for imports. It is not enough either that, even without inflation, the investment contemplated should tend to make the country self sufficient in some field, if it is at the expense of higher costs throughout the economy, and if therefore it constitutes a threat on the export potential of the country. Just as the internal value of a project cannot be judged only by its direct earnings power but must be assessed on the basis of its indirect effects, in the same manner these indirect effects of an investment program are not relevant only insofar as they affect directly the national production but also as they affect the general cost and foreign transact-



ion pattern of the country. The greater the expected expansion in foreign transactions of a country, the greater its chances to supplement local <sup>resources</sup> ~~savings~~ with foreign capital.

I have brought up these questions because in assessing what we commonly call creditworthiness and choice of priorities, they are ever recurring. We have no ready made formula to solve these problems. They imply quantitative appraisals but also qualitative judgments on the potentialities of the country and its physical and human resources on what its people really want and what they can absorb. Mr. Knapp and Mr. Larsen will deal in more details with some aspects of it.

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FINANCIAL PRESS



ECONOMIC DEPARTMENT

Leonard B. Rist

October 14, 1949

INFORMATION MEETING OF OCTOBER 14, 1949

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Gentlemen,

I have been wondering what might be of interest to the representatives of the financial press which we all read with interest and benefit. Indeed you are one of our most valuable sources of information. I think, therefore, that rather than describing to you our methods of investigation - and a lot has already been told you today by my colleagues on that subject - I might try to sketch the economic background against which we evaluate the risks we take. I will do that from the point of view of Europe, because Europe still represents 5/7 of our portfolio and is, therefore, our greatest risk, and more generally, because the future of Europe is of major importance to

any other country to which we may be called upon to grant loans.

It has often been wondered why the recovery of Europe has not been patterned after the period which followed World War I. Actually there has been very considerable disagreement in Europe about the most suitable mechanisms of recovery and the abandonment of controls on exchanges and trade has been advocated much more often than is realized here. The debate took several forms : liberalism vs. statism or dirigism, price mechanism vs. controls and rationing, fluctuating vs. fixed exchanges, self-sufficiency vs. reliance upon foreign assistance. Why, it was asked, did the European countries not let automaticity play the role it did after World War I ? Why did they not allow the balance of payments on current account to adjust itself through exchange depreciation rather than waiting for equilibrium in the balance of payments to be achieved before adjusting exchange rates ? A comparison of what happened after



the first World War with what is happening now may, perhaps, throw some light on these discussions. I think that it will indicate that the policies of the European countries can be fairly well explained by the conditions in which they found themselves. But it will also indicate, I believe, that we are now reaching the point where precisely these mechanisms of adjustment, apparently neglected until now, can again play an important part.

The reason for the different choice of mechanisms lay in part in the very magnitude of the physical destruction and of the structural changes which had taken place. I will not discuss further the physical destruction. Its extent and severity are too well known. But the political shifts and their effects on the pattern of trade are worth listing once more because of their more permanent consequences.

Both economically and politically the world of

1949 is very different from the world of 1939, much more so than the world of 1919 was from that of 1914. Russia, which practically disappeared from world commerce after 1918 and is still of small importance in international trade, is now a major political power, and has expanded its influence over most of Eastern Europe, not to mention Manchuria, half Korea and a growing part of China itself. Its trade with the "satellite countries" of Eastern Europe has increased over prewar and the latter must try to attain some kind of equilibrium at a lower level of trade than existed before the war. The problem of East-West trade is not so much that the countries do not want to trade. Actually the volume of trade has been rising, slowly but steadily, and has now probably reached about two-thirds of prewar. It proceeds more or less on a barter basis, however, and since the East cannot export more to the West than it does, it cannot import more from the West as long as credits are not available.



The Far East was undamaged and open to trade in 1918. Today a shift in political power of tremendous international significance is taking place in China. Japan is now deprived of its empire and under military occupation. India and Pakistan have arisen as independent states. Destruction and unrest have been widespread in South East Asia. Indeed the disappearance of much of the Far East as a large trading center and the possibly reduced capacity of South East Asia to earn dollars for Europe from its exports of rubber, tin, etc. may be one of the most dangerous changes in the pattern of trade.

The Middle East, which was after 1918 the fragmentation of the Ottoman empire, now assumes a new importance because of its strategic position, its oil resources, and through the new born state of Israel. Africa has also assumed a new strategic importance, and it too may eventually become a substantial market and supplier,

particularly for Europe. Unlike the Middle East, however, whose oil is already making a significant contribution to European resources, Africa will undoubtedly be a drain on Europe for a considerable time.

The war saw a significant degree of industrial development in Canada, Latin America and other overseas areas but the greatest changes of this sort took place here in the United States which practically doubled its prewar industrial output and at the same time increased its agricultural production by about 30 per cent. It became the only major potential capital-exporting country, and for the years 1946-48 its surplus on merchandise, transportation, investment and other current items reached the enormous total of about \$25 billion compared with roughly \$10 billion in 1919-21.

These changes were magnified by the fact that they occurred at a time when Western Europe, the other



major industrial center in the world, was greatly weakened. The international economic position of the U.K., which had liquidated a substantial proportion of its foreign investments and assumed a new load of external debt, gave particular cause for grave concern. Germany was for long a vacuum, and in Western Europe generally, with local resources allocated by priority to local needs rather than to exports, the import surplus required to prevent the whole social fabric from disintegrating was enormous. This surplus was financed, and indeed supplied mainly by the United States, which in the four years ending June 30, 1949 made available to the ERP countries grants and loans amounting to no less than \$8.1 and \$8.3 billion respectively, or a total of \$16.4 billion.

Besides these changes, which completely disrupted the prewar patterns of trade and were too grave to allow for more than a partial return to what we used to consider



normal, besides the ever recurring threat of war which keeps up military expenditures at a high level all over the world, other conditions had been modified since 1918. Population movements are no longer more or less free. In 1921-24 intercontinental net emigration from Europe probably averaged in the neighborhood of 600,000 per annum. At present it is only from  $1/3$  to  $1/2$  of that figure (1). Last but not least, after the first World War, private capital, notably American, was willing to seek outlets abroad. New issues on the New York market for foreign account averaged over \$700 million per annum from 1919 to 1928 and fell below \$400 million in only two years (1919 and 1923). Mindful both of some previous unhappy experiences and of the far greater political risks involved, American bankers and investors were wary of loans to foreign countries after 1945.

Total new issues for foreign account since V-J day have

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(1) Compared with net immigration of about 400,000 per annum in the period from 1921-24, immigration into the United States for permanent residence over the past three years has averaged about 150,000 per annum.



hardly exceeded \$500 million in all, of which by far the greater amount has gone to Canada and Royal Dutch Shell. It is true, however, that private direct investment amounting to roughly \$1,500 million in 1946-48 has been more than four times as large as in 1919-21. But the aggregate of both loan and equity private investment hardly exceeds 2 billions over the three year period. This figure, compared with the U.S. current surplus of \$25 billions, describes the dollar problem in a nutshell.

Under conditions such as these it is hardly surprising that, although the pattern has varied significantly from country to country depending on particular circumstances and traditions, the policies of postwar recovery have placed less emphasis on automatic processes of adjustment than was the case following the Armistice of 1918. It was only natural to keep in force after the war strict measures of control, many of which had



been adopted while hostilities were still going on. Resources still had to be husbanded and inflation contained. The alternative was to abandon controls and let the currency depreciate to a point which would have threatened or perhaps even destroyed entirely the social equilibrium which was often already precarious. The vision of the United States in seeing what would be the consequences of such a step, and its willingness, by the Marshall Plan and all the other forms of postwar financial and economic assistance, to allow Western Europe to maintain a level of imports, and thus a level of consumptions and in particular investment, far larger than Europe's own resources would have permitted, is without doubt the most noteworthy act of foresight, statemanship and generosity of the postwar years.

Largely as a result of United States assistance, the transition from war to peace in Europe has been



smoother than it was after 1918. Then it was accompanied by heavy unemployment and turbulent labor relations.

In the United Kingdom, for instance, about one man in five was unemployed at the depth of the 1921 slump.

Again, an annual average of about 15 million man-days were lost through strikes in France, 49 millions in the U.K. and 14 million in Italy in the period 1919-21.

This time, though the wartime dislocation of industry was far greater, the transition passed without heavy unemployment, and apart from strikes in France and Italy the causes of which were as much political as economic, interruptions by work stoppages have on the whole been far less acute than in the period following 1918. It may also be mentioned that the uncoordinated manner in which exchange stabilization was carried out after the first World War was not unconnected with the competitive depreciations of the thirties. Remembrance of this may have played a part in the choice of fixed parities rather than fluctuating rates after the second World War. But

this decision was no doubt reinforced by fear of the economic and social consequences of the internal price rise which exchange depreciation would have produced, and by the knowledge that the volume of European exports could be only slowly expanded. It was rendered effective by the financial assistance of the United States.

Now, however, although a great deal of war damage to property, notably housing, has still not been made good, most of the physical reconstruction of plant and equipment has been completed. Industrial production in Western Europe is now probably about 15 per cent above prewar and the volume of agricultural output is approaching prewar levels. Thus in areas where destruction was much greater than in 1914-18, the speed of recovery in the past few years compares favorably with the earlier period. Even though blessed by favorable weather conditions, European agriculture, for example, did not reach prewar levels of production until the eighth year after the



first World war. This time after four years we are close to it.

The inflationary boom of the postwar years probably passed its peak last spring. In general prices now show a horizontal or slightly downward trend. Conditions, of course, vary from country to country. In Belgium, for example, where the deflationary process has gone furthest, it has led to significant unemployment, while in the United Kingdom a certain measure of inflationary pressure still appears to persist.

The budget deficits of most countries, which were an important factor in the inflationary process, have been substantially and sometimes even spectacularly reduced. In Italy, for example, the budget deficit has fallen from a high of 787 billion Lire in 1947-48 to an estimated 174 billion in 1949-50, while the Dutch deficit of 546 million guilders in 1949 is expected to give place to a surplus of 20 million guilders in 1950.



Budgetary equilibrium has already actually been attained in the United Kingdom and in Belgium. The balance in both, however, is still precarious. In Belgium it was achieved at the cost of substantial unemployment which now threatens to upset it, while in the United Kingdom government expenditures have recently been running lower and receipts higher than was estimated and as in all other countries the recent devaluations will subject the monetary equilibrium to new inflationary pressure.

In view of the rise in production and the approach to monetary stability, the question must be raised whether the time has not come for policies of greater flexibility to be given more scope than has hitherto been the case, for greater reliance on the price mechanism and on normal capital flows. This does not mean that the need for extraordinary assistance is over, for despite the marked improvement since the close of hostilities, the balance of payments position of Western Europe, especially with



the dollar area, is still weak and remains its most intractable problem. The trade deficit of the ERP countries with the U.S. and Canada (on the basis of U.S. and Canadian figures) which has totalled \$2.9 and \$2.1 billion respectively in the first six months of 1947 and 1948, still amounted to no less than \$2.1 billion in the first half of 1949. But it may well be that now with emergency reconstruction behind us, with the return of a buyer's market and with the security afforded by the continuation of ERP aid, although at a decreasing rate, until 1952, a part of the adjustment still to be made may be brought about by more traditional means. Risks which could not be assumed two years ago can now be faced. Competitive markets, rather than artificial relationships based on a cheap scarce dollar, may well bring about substantial changes in trade currents.

The recent devaluations are the first important step in that direction and some measures are also being

taken to liberalize intra-European trade and to reduce U.S. tariffs and simplify customs procedures. It may be pointed out that the success of devaluation against the dollar does not depend entirely on the increase of European exports to the United States or on a decrease of \$ imports into Europe. The recent realignment of currencies, by improving the competitive position of Europe should lead to some substitution of European for American products in third markets. This does not mean a permanent loss of business for the United States, since a better balance in world trade is a primary condition for the maintenance of a high level of American exports.

If, at the same time, adequate steps can be taken in the European countries to prevent the inflationary pressure generated by the currency adjustments from



leading to a new race between wages and prices, in other words, if devaluation brings, at least for the time being, some reduction in real incomes, if at the same time economic stability is maintained notably in the United States, and continued efforts made to reduce obstacles to imports, and if European sellers are willing to adjust their methods to American needs and habits, the remainder of the readjustment process may be greatly facilitated. In this process adjustment on the capital as well in the current account of the balance of payments should play an important role. For current deficits have often been inflated as much by the exodus of flight capital as by the disinclination to sell abroad goods which find profitable market at home. If now, returning confidence and price advantages in the import and export trade can influence current transactions, if on the other hand the flow of private capital can continue and can be encouraged, the improvement

in the European balance of payments may proceed at an accelerated pace and the last part of the road to recovery may be covered more speedily than has sometimes appeared possible.



BANKERS

Leonard B. Rist

I suppose that, rather than hearing about our internal machinery, you would be more interested in the general background against which we appraise the loans which we are making or have made. You are already familiar with the former and our methods of investigation are hardly different from those which you follow yourselves in the course of your own business.

The risks we are taking are, by definition, those which the market could not bear, but which seem remarkable. As you know, according to our Articles, we must assure ourselves that a) the borrowing cannot be made in the market on reasonable terms and b) that nevertheless the loan has reasonable prospects of repayment. We have 'til now accepted to take such "calculated" risks for an aggregate amount of over \$700 million. An appraisal of such risks is by no means a mathematical problem; it is a matter of judgment and is all the more delicate as this judgment must take into account the life span of the loan.



As you are aware, our liability for a loan operation runs through the whole life of the loan, unless we can resell our portfolio without our guarantee, an event which has not yet occurred. Whenever we have sold bonds from our portfolio, it was with our guarantee attached to them. We, therefore, must attempt to appraise the risks which we are covering for a fairly long period. It has occurred to me that you might be interested in a comparison of European risk - our major investment 'til now - as it appeared to us at the time we made our biggest loans to the European countries and as it appears to us now. I chose Europe, because out of our \$716 million portfolio, \$546 million are European loans. I do think that such a comparison will show that on the whole there has been an improvement in the quality of our portfolio than a deterioration.

Our main loans to Europe were dated as follows:

France	\$250 million	May 1947
Netherlands	\$195 "	August 1947
Denmark	\$ 40 "	August 1947
Luxembourg	\$ 12 "	August 1947
Netherlands	\$ 12 "	August 1948
Belgium	\$ 16 "	March 1949
Netherlands	\$ 15 "	July 1949
Finland	\$ 12.5 "	August 1949

It is mainly a comparison between 1947 during which we incurred a liability of over \$500 million, and 1949 that I would like to draw.

In 1947, the so-called political risk was probably less apparent than now; the Berlin problem had not yet taken the bitter aspect it took later on and while a peace settlement did by no means appear to be easy to achieve, the alternative did not seem to be peace or war. On the other hand, reconstruction was, by far, not completed; the industrial production was in the neighborhood of 80% in 1946/47 (on the 1937 basis) for France, and Netherlands,, around 100% in Belgium and around 105/106% for Denmark.



Scarcities and, therefore, rationing were the rule; inventories - and especially inventories of raw materials - were conspicuously low; transportation was hampered by inadequate railroad equipment; except perhaps in Belgium, inflation was still being felt everywhere. Including the Netherlands where tight controls were being exercised, inflationary pressures could be felt all around. The usual tendency towards higher wages and labor disturbances was almost general. The purpose of our loans was then to allow production to increase further and the expectation was that as production increased, both needs from abroad and internal inflationary pressures would be reduced. There was no doubt as to the basic fragility of the European economy, but the fundamental assumption was that no major disruption would take place. It was expected that consumption would increase further without an undue recourse to foreign assistance, while investment could continue at the same pace, adding modernization to reconstruction. The foreign indebtedness of the countries concerned was considered relatively high, but in view of the long and excellent tradition of these

countries as foreign debtors. the willingness to pay could not be questioned. We knew that the governments involved would impose new sacrifices and forego useful or pleasant imports rather than default on their signature. It did not seem then that these sacrifices would be too great, because the ability to repay could be expected to improve. Monetary reserves were still substantial and foreign securities seemed to provide sometimes a sufficient cushion. The balance of payments prospects were not very dim, and while it was realized that time had to elapse, it seemed that when exports would pick up, some balance - though not as comfortable as prewar - could be restored. The convertibility of the pound was just about to be reinstated.

What is the position now? If anything, the willingness to pay has been reinforced thanks to the greater stability which has been attained in the economy of the countries concerned. Inflation seems to have run its course in France; it is well under control in Holland; it has not crept up in Belgium or Denmark. The degree of financial stability achieved, which will be described to you more



in detail by Mr. Rosen, goes with a degree of social stability almost comparable to prewar. As to production, it has increased everywhere to levels which approximate 130 of prewar in Denmark, 115 to 120 in France and over 120 in Belgium and the Netherlands. Transportation conditions are normal; as to foreign trade, a great improvement has taken place in Belgium and France, imports are in volume at about the same level as in 1947, which is between 5 and 10% over prewar, while exports have substantially more than doubled as compared with 1946/47 when they stood at one half of prewar. Even Germany's production has now recovered to about 80% of prewar. This may foreshadow a return of Germany's competitive power but in the meantime is a help to its neighbors, in particular, Holland.

Two aspects of the situation appear, however, in a new light: the political situation and the dollar problem.

There is no need to describe how the relations between East and West have deteriorated over the last two and a half years. On the whole, the Communist parties have not been able to gain a

foot in the governments of the Western countries in spite of the numerous periods of social tension. At the same time the military problem was becoming more acute, and it is not until the signing of the Atlantic Pact that the anxiety subsided in the West of the European continent. It would be an error to believe, however, that this atmosphere of tension and the fear of renewed war and occupation have prevented recovery or even foreign trade. They have, no doubt, left heavy military burdens in the budgets of each of the countries concerned, but trade between East and West has been growing constantly at the rate which barter exchange could carry. Little or no credit is involved in operations on that basis (on the basis of barter); the development of East/West trade can only be slow, and this involves for the Western European countries the need to find other markets for their products than these traditional outlets.

At the same time, in the Far East, in Indonesia Indochina and worse in China itself, traditional markets for European goods were progressively shut out or considerably reduced: here also



an important readjustment of export outlets is necessary. South East Asia has been formerly a dollar earner for Europe generally, except for Malaya one cannot say that the area is apt to play this role for a long time and from this standpoint, the hopes which could be entertained two years ago are fading away.

Thus, the political developments have had important economic consequences in the field of foreign trade and foreign exchange and have pointed out the necessity for the European countries to earn dollars themselves. The failure of the British attempt to restore convertibility acted as a danger signal; both Europe and the U.S. had underestimated the amount involved, and the Marshall Plan was the official recognition that the gap has been much wider than anybody could foresee. The main effects of the Marshall Plan, as far as the Bank is concerned, will have been to prevent a setback in reconstruction, to hasten the restoration of Europe and to allow reconstruction and modernization to take place at a standard of life definitely higher than would have been possible otherwise. It did not solve and cannot solve the

problem of redistribution of foreign trade which I mentioned before and which focuses on the dollar shortage all the energies of Western European finance men. As I intimated before, it is not only necessary to restore production to a level higher than prewar in order to offset the loss of foreign investments, but the traditional channels through which triangular trade allowed Western Europe to earn dollars have been upset while in addition the reliance on Western hemisphere sources of supplies have grown greater. These are the basic reasons for the recent devaluations. One may dispute on the exact timing of the operation but it was certainly better and more useful to wait until a buyers market seems to be setting in. In order to be able to achieve their aims, i.e., to shift from dollar supplies and to develop the exports to the U.S. or the dollar area generally, it is necessary to have some leeway in the choice of one's suppliers and to have some available productive capacity. It would, therefore, not have been wise to take this momentous step very much earlier; it would not have been wise either to wait until the Marshall Plan



had run its course, to effect the necessary readjustments, they would have been much too deep then. At a time when U. S. supplies are still well assured through the Marshall Plan, but at the same time some flexibility appears in the world markets, an operation like wholesale devaluations should properly be undertaken.

What will be the effects of it, it is much too early to predict. Nobody can say with any certainty what prices will be affected and whether the working classes in France or Britain will accept only slow and reasonable changes. But at least the basis is set for a readjustment of trading operations since dollar goods are less attractive and dollar markets are more attractive.

This will affect the dollar countries in two ways: partly because they will have competition from European goods on their own territory, and partly because their exports will hit against much stronger competition from European producers. It should be realized in this connection that a large element

of artificiality existed in the former exchange rates. There was also an element of artificiality in the very ample markets which American exports could easily find abroad. To the extent that European currencies were over-valued the dollar was under-valued. It is only clear that the dollar deficit is nothing but another way of expressing the fact that U. S. export more goods and services than they import; the exports are to the tune of, say, \$100 per head while imports are only to the tune of 60 or \$70 per head.

Everybody asks the question whether devaluation will now allow this dollar gap to be closed. This balance of \$30 to 40 per head must be covered either by less exports or by more imports or, if trade changes are not sufficient, by foreign credits. Will the new rates of exchange allow trade alone to fill the gap? Nobody knows the answer, but one can at least guess what the trend will be; some element of competition has now been restored in the world. The prices offered by the various suppliers here and



abroad can now be competing in third markets. It is even possible that some countries which 'til now are considered by Europe as members of the dollar area - Brazil, for instance - should restore their exchanges with other countries than U. S. to the point where their balances with Europe will no more need to be settled in dollars. By making prices more comparable and by restoring healthy competition, a better utilization of resources the world over will be achieved. More efficiency, more flexibility, more incentive for low cost producers, this should result in a reduction of the American surplus, i.e., a reduction in the dollar gap, provided of course that both the devaluating countries and the dollar countries are ready to be reasonable, that is 1.) the former should not increase their costs unduly, and 2.) the latter should accept imports and competition abroad. A reduction of the gap does not, however mean its elimination and capital movements will have to continue for quite some time and that the adjustments will not be 100%. The important thing, to my mind, is that the trends should be in the right direction and it is difficult to figure how this could not be the case.

Such are, Gentlemen, the broad lines of the present picture, the background against which we try to weigh the risks incurred in individual countries. I do feel that, while the payment problem has become dangerously acute during the past year and a half, the prospects look brighter again both over-all and in the individual countries.

I should ask my friend, Mr. Martin Rosen, to comment on the particular aspects of the same problems relating to each of our principal European debtors.

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25 April 1949

STATEMENT MADE AT THE INFORMATION MEETING

with the AMBASSADORS

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Before describing how my department works, I would like to indicate in the light of what considerations we have organized it. When the League of Nations was split up between the United Nations and the Specialized Agencies, its economic services were split up at the same time. None of the Agencies - and the United Nations least of all - considered that they could carry all the load which the League has been carrying partly because its activities were more comprehensive and partly because the type of problems is different. In the Bank we have geared our studies mostly to our financial operations.

In carrying out our studies, we have to stress most of all the structural aspects. While short-term problems and immediate difficulties, while facts, figures and analyses are of course relevant and necessary, it is the permanent features and the long-term prospects of the economies of our member countries which we must underline. In doing this, we must inevitably take into consideration, in addition to the historical facts, the policies both economic and financial which our member states are pursuing. The adequacy of these policies in term of their economic structure and prospects, the chances we can discern that these policies will be successful are, therefore, essential to any of our investigations.



The character of our studies derives largely from our responsibility as a cooperative institution to our borrowing members who are entitled to a fair and thorough analysis of their position, and also our responsibility to the other member nations who act as guarantors. In approaching our problems from this angle, we have found ourselves sometimes in a position to render a service to the borrower as well as getting service from them in term of valuable data. In our relations with our borrowing members, there has been established a relationship of sincerity on both sides which allows us to raise our questions, and if the case may be, to express our doubts, with complete freedom, and we have found a response unusually remarkably sincere and rewarding.

This freedom of expression has been particularly useful in the discussions of the policies of the countries concerned. This is one of the reasons why our studies have never been given wide circulation : we make use in our reports of the opinions expressed by the government officials and private persons whom we may have talked to, we will not feel justified in publishing the opinions we have formed on the basis on such confidential talks.

I have a fairly extensive group of economists working on these problems. Perhaps the number of operations which we have performed provides a good explanation : from 1920 to 1930 the League of Nations performed six or seven financial operations, directly or indirectly, the Bank has already made <sup>eighteen</sup> seven loans in <sup>three</sup> two years and we have a large number of applications under study.

We have broken down the department, which includes <sup>40</sup> 55 professionals representing 14 nationalities, into three main groups.



One concentrates on country studies, the other one on functional or technological problems, the third deals with general problems.

The functions of the first group are clear enough. The economists in charge provide economic reports on the position and prospects of our member states. I have pointed out earlier that their main concern is with the long-term outlook.

The technological group includes one economist with one or two assistants for each of the particular field of agriculture, industry, transportation, minerals and manpower. It has proved an exceedingly useful set-up. Its functions are several : in the first place, a large number of countries, particularly the less developed ones, are depending on one, two or three main products which they export ; the future market of these products is of immediate concern. It would be difficult for the general economists who are in charge of the area group to be conversant at once with credit, foreign exchange or development policies and with the prospects of coffee, cotton or copper. The specialists of the technology group provides them with those studies. They also serve another purpose in helping us in the preliminary stage of a loan application to appreciate the economic implications of a project. They are supposed to give a preliminary opinion as to the extent to which the development contemplated is in a general way consistent with the economy of the country, and to assist in determining whether the results which the country expects to obtain from this project are likely to be realized. They do not need to go into the technical details which are the responsibility of the engineering adviser to the Loan Director.

The third group of my department is the general studies group. We cannot treat a country as isolated and we must consider each of them within the framework of its world relationship. This



task of coordination falls upon the general studies group. Their research revolves around three main problems : one of them concerns the movement of international capital ; we must form an opinion as to the prospects of international movements of capital not only in the field of international lending, but in any other form, be it direct investment or grants. We also must form an opinion of the past developments of such movements, the debt record of the individual member states as well as the treatment accorded to private investment on their territory are directly connected with this general problem. The obstacles and incentives to further movements of capital are similarly the object of our research. The second consideration relates to the balance of payments of the United States, at present the greatest lending country, in particular, what is the future of imports of foreign products into the United States. We have tried to deal with this problem from a very practical point of view, taking into account new production of substituted goods ; we have attempted to determine for individual commodities such as oil, textiles, hardware, etc. what prospects foreign goods are likely to find during the next few years in the United States. The third point around which we have concentrated our efforts is the problem of development in general. Some of you may have seen the letter which the Bank sent to Mr. Trygve Lie at the beginning of last year on the Bank's point of view concerning development policies. This was the result of a series of studies carried out in this particular field and was an attempt to give the Bank's present view on it.

Before closing, I would like to say a word about our sources. Besides all the published material which we can get, they include



other international agencies such as the United Nations and its regional offices, I.L.O., etc. Both F.A.O. and the I.M.F. are located in Washington and this has allowed us to develop at working level a cooperation which we find most useful. The Fund in particular is regularly providing us with a large amount of information and our two Research departments work hand in hand. In addition to international agencies, we found a ready cooperation in American government agencies, such as the Department of Commerce, the Department of Agriculture, the Federal Reserve Board, etc. I think I can say that in no country would an international organization find as quick and ready cooperation on the part of the local authorities as we have found with the United States authorities. They have opened their files freely to us and have given us their opinions with a complete reliance on our discretion which can only be termed exceptional.

Private business has also been of great assistance ; we have called on banks and private American firms which have interests abroad, they were exceedingly responsive and understanding.

The member states remain, of course, our most important source of information. As I pointed out earlier, they are open, sincere, helpful, and at all times show a great readiness to cooperate, whether our questions were discreet or indiscreet, they show an amazing degree of frankness in answering us. Clearly, direct contacts are the easiest means of information. Missions are, by far, better than writing letters ; they achieve more and more quickly, and if these direct contacts can be kept up, they become personal and all the more useful.

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