INTERNATIONAL MONETARY FUND

Executive Board Meeting

Meeting 94

1818 H Street, N. W.

10:00 a.m., November 19, 1946

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Camille Gutt, Chairman

George Bolton
G. W. J. Bruins

J. V. Joshi
Y. C. Koo
Jean de Largentaye
J. V. Mladek
Louis Rasminsky
Ahmed Zaki Bey Saad

Harry D. White

Ernest de Selliers
Maurice H. Parsons

Raul Martinez-Ostos
B. K. Madan

Mihailo Kolovic

Mahmoud Saleh El Falaki
Octavio Bulhoes

Frank Coe, Secretary
Phillip Thorson, Assistant to the Secretary

Present for Items 3 and 4

E. M. Bernstein, Acting Director, Research Department
Miss Renna Zafiriou
Miss Gertrud Lovasy

The minutes of meetings 87, 88, 89 were read and approved as revised.

1. Initial Par Value

In connection with the minutes of Meeting 89 a question was raised concerning possible overvaluation of the European currencies with respect to the pound sterling. It was thought that in export markets the competition of the United Kingdom was the most important factor for the European countries, and that in view of the quick revival of British exports and the improvements which are taking place in the British economy, the countries of Europe had to be careful not to overvalue their currencies in relation to the British pound.

2. Initial Consideration of Par Value - South Africa

Mr. Bruins, as Executive Director representing South Africa, made the following expose:

"Mr. Chairman, gentlemen.

By a happy coincidence a few days ago I had the opportunity of discussing the position of the South African currency with Dr. J. E. Holloway, Secretary for Finance of the Union of South Africa and Acting Governor of Fund and Bank at the Governors' meeting of September last.

Dr. Holloway, who at the present moment has returned to New York, did not deem it necessary that a representative of South Africa should assist at the present discussion, the less as in his opinion the memorandum of the Research Department (E. B. Doc. No. 116) gives a clear, well balanced and true picture of the situation. He wishes to congratulate the author for this excellent piece of work.

In fact neither in the development of prices and wages, nor in the balance of payments nor in the financial and budgetary situation of the country is there any indication of tensions or weak elements which could influence the value of the currency. The reserves of the country, moreover, are much higher than before the war, whilst the foreign debt of the Government, which stood at £ 104 millions 15 years ago, has decreased to some £ 10 millions.

The decrease of the foreign debt is in the first place a war phenomenon. It must, however, be pointed out that already before the war the policy as to foreign loans had changed materially. Until 1931 foreign loans had increased continually. Since that year, however, no foreign loans of £ 5 millions in 1938 for the sole reason that the level of interest within the country was considered too high at the time. At the outbreak of war the foreign debt totalled some £ 90 millions.

A few remarks of a subordinate character on some statements in the memorandum may follow.

On page two it is said that 'vast sums were spent directly by the state for the benefit of agriculture, totalling £ 111 millions between 1910 and 1936.' It is true that in large parts of the Union agriculture suffers from unfavorable climatological conditions. The sum mentioned includes, however, not only the administrative costs of the Department of Agriculture, but also all the expenses of the agricultural school system of the country during these 26 years.

To the remarks on page 3, paragraph 2, should be added, that a native labor class in the ordinary sense of the word hardly exists. There is a perpetual coming and going of natives to the industrial centers, especially to the gold mining industry, even from parts outside the Union, the great majority of the men working for a certain time in the mines and then returning to their native village with the earnings of their labor. It is not clear what is meant by 'open measures of compulsion.'

These few observations, however, have no bearing on the question before us and I shall take no more time of the Board.

The South African Government proposes to accept the present rate of the South African pound as the initial par value under the Fund Agreement. I believe that the Board can agree to this proposal without the slightest hesitation."

In answer to the question on native labor, Miss Zafiriou said that the source for the statement in the Research memorandum was "Capital Investment in Africa" written by the South African expert, Dr. Frankl, and published in London in 1938. Mr. Bernstein added that, on the basis of a recent article in an American journal by authors who had visited the country, he understood that measures of compulsion were still in effect. Mr. Bernstein commented that South Africa's balance of payments depends on the mining of gold and this industry and South Africa's balance of payments would be affected by either a rise in wages or a shortage of workers. There followed an exchange of views by members of the Executive Board, with a difference of opinion as to the status of labor in gold mining and its significance for the problem in hand.

No action was taken on the par value for South Africa.

3. <u>Initial Consideration of Par Value - Czechoslovakia</u>

Mr. Mladek made the following statement:

I believe that the understanding of the present Czechoslovak situation may be facilitated a great deal by a brief sketch of economic development since the end of the war.

At the beginning of the war, the country had been actually torn into four administrative units with the result that in 1945 it emerged with four currencies and four different structures of prices and incomes. Unification of currencies had been effected gradually and in November 1945 a new common currency unit had been introduced while the volume of currency in circulation had been sharply reduced and a major part of deposits blocked. Simultaneously an effort has been made to unify the system of wages and prices all over the country. Prices and wages being high in the eastern part of the country, the equalization of price and wage levels brought about a rather sharp increase in prices and wages in the west. Comparison of price indexes of the United States, the United Kingdom and Czechoslovakia at the beginning of 1946 betrayed some over-valuation of the koruna at a parity which had been adopted in November 1945, that is: two United States cents per one koruna, or fifty koruna per one dollar and two-hundred-one and a half koruna per pound sterling. The magnitude of over-valuation, however, was dwindling considerably in respect to the dollar with the progressing rise of prices and wages of the dollar (and to a somewhat lesser extent in respect to the pound sterling), and has been reduced to a less impressive ration than the one which prevailed in the Spring of this year.

The foreign trade of the country which was halted in the first months after liberation, has been recovering steadily since then, and especially during the late Spring and Summer of this year the increase of exports proceeded at a very satisfactory rate. The assertion of the Research Department document that so far export has by no means been limited by the prices of goods, being determined entirely by the present output and transportation facilities, seems to be correct.

Industrial production has not yet recovered to such an extent as to come close to the pre-war level, with some exceptions, of course. It is a stated objective of the government-sponsored two years plan to bring the output to the pre-war standard and to exceed it is some essential sectors. The main difficulties in the field of production are, besides direct damages arising out of war action, the deterioration of plant equipment, e.g. in textiles, and the shortage of raw materials, which turns out to be a bottle neck factor from time to time in one industry or the other. Some of the industries are working on a day-to-day or week-to-week supply of raw materials. It should be noted that there is hardly one industry which is altogether independent of imported raw materials and some of them depend almost entirely on imports.

The memorandum of the Research Department stresses as an important item of the overall picture of transitional difficulties, the shortage of labor. It is true, that a part of the problem can be solved by removing the maldistribution of labor which may still persist. On the other hand, it is true that full account ought to be taken of the exodus of the German population. Quite a number of the German labor had been employed in industries working mostly for export. There is no doubt that some reduction in the output of the industries concerned is to be considered. There are, however, some offsetting factors, too, which should be kept in mind. The total need of imports will be reduced in proportion to the diminished population; only a part of the departing German population was engaged in industry, the other being busy in agriculture. Of those engaged in industry, quite a number were employed in non-export industries. The proportion of the Czech element in traditional export production, like glassware, china and textiles, increased rapidly in the inter-war period and quite a number of the most modern plants were actually run and manned by Czech nationals. Some other sectors of industry, like the shoe, the tool and the machine industries, were predominantly Czech. Moreover, it is likely that some of the industries, the output of which is going to be reduced on account of the German exodus, would have been reduced anyhow as the world market is changing and calls for certain shifts in the composition of Czech exports.

In the course of a few years, the departure of the German industrial population may prove to have caused no irreparable cut-down of the production capacity of Czech export industries; it may, however, work in the unfavorable direction by developing a competitive production in other parts of the globe.

As far as the balance of payments is concerned, it is difficult to make any dependable forecast. It is the prospective exports that must be taken as a safe margin of the magnitude of the balance of payments. Any excess of imports over exports will be determined by the size of credits available, as the country's monetary reserves are rather limited. There is no doubt that shortage of credit would slow down the process of reconstruction and might even imply restrictions in the consumption. Considering, however, the implications of a shortage of currencies for the stability of the rate of exchange, it should be kept in mind that the country is taking advantage of a comprehensive system of foreign trade licenses and foreign trade control so that shortage of foreign exchange has, at least in the short run, hardly a direct effect on the rate of exchange.

In regard to the fiscal policies, it appears that the present budget shows little or no danger of inflationary effect. The volume of currency is somewhat above the level originally envisaged but can stand favorable comparison with most countries, even those not occupied by the enemy during the war.

As to the rate of exchange itself, I have received no communication of the Government's decision as yet. An indication has been made, however, from Prague, that they desire to maintain the present par value. I understand that they hope to overcome the over-valuation of the koruna in the course of the transitional sellers market period and obviously they hope that they would find a full understanding with the

Fund for a necessary adjustment of the rate of exchange if the effort to overcome the over-valuation would for some reasons not meet with success. I do not pretend that it is an easy objective to reach a level of prices which could successfully pass a test once a period of hard competitive struggle developes. There are, however, a few considerations which make the present downward change of par values rather difficult. There is a general uncertainty as to the price and wage developments in many parts of the world, not excepting the United States. Czechoslovakia is, moreover, in a peculiar position, trading with countries which, with the exception of the U.S.A. and the United Kingdom, almost all have a currency over-valued with respect to the dollar and the pound sterling, and quite a few of them have a currency considerably over-valued with respect to the koruna.

Discussion by the Executive Board took account of foreign loans made to Czechoslovakia, exchange and trade agreements with other countries, probable effects of the termination of UNRRA assistance, and the results for the budget of profits or losses in nationalized industries. It was agreed the discussion would be continued at the next meeting.

Approved: February 7, 1947