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SUMMARY

In his article «International Economic Equilibrium and Foreign Exchange Rates», Prof. Robert Mossé takes up a decisive critical position with regard to monetary devaluations as a remedy for the disequilibrium of international payments.

The A. examines a theoretical examination of the effects of exchange rate variations under a fully planned economy, in a socialistic economy based on price mechanism, in a free or quasi-free economy, and under a mixed system; and in support of his thesis he discusses the practical results obtained, comparing the variations of exchange rates in Great Britain and France during the inter-war period. In his opinion, the favor so strongly enjoyed by the system of currency devaluations — «undoubtedly a tempting method for the government» — is partly due to tenacious delusions still surviving a spontaneous nationalism, and partly to vested interests that find in devaluation profit opportunities.

... The New York Times of March 2, 1950, has called attention to a new plan for medium-term financing of international trade that does not require the use of dollars, a plan developed by a group of European bankers in consultation with experts of the United Nations Economic Commission for Europe.

«The basic idea — which originated with Prof. Pasquale Saraceno — is to tie together the spotty but growing idle potential in the mechanical industries in Western Europe, the unemployed man-power and the considerable idle resources of short and medium-term capital in Switzerland and possibly other European countries. The key to the plan is the introduction of a new medium-term credit instrument that would ensure the combined guarantee of the importing and exporting countries' banks (or even of the governments) and, upon endorsement by a neutral banking institution, could be redeployed in the capital market of Switzerland, Belgium, or some other country where medium-term funds are readily available».

«The economic justification for using new credit to finance production for export by such means is that the plan would not be inflationary. Because confined to industries with unemployment and idle plant capacity, and because only part of the increased exports would be without immediate return through imports, the dangers of ordinary credit expansion to finance exports would be avoided, the sponsors believe. This is the major point in selling the plan to the cautious Finance Ministries who are still avert to the recently curbed inflation in their monetary systems».

Prof. Pasquale Saraceno, with the kind consent of the Economic Commission for Europe, has accepted our invitation to publish his plan. It is presented here, except for slight retouches, in its original form of a study prepared in 1958 in connection with discussions which took place in the Permanent Economic Committee of the World Federation of United Nations Associations (WFUNA), under the title: «The Development of Export Trade of European Industrial Products and its Financing». 
International Economic Equilibrium and Foreign Exchange Rates

by ROBERT MOSSE

1. - The series of monetary devaluations hastily made in September and October 1949 were accepted by some as a decisive remedy for the disequilibrium of international payment accounts. Personally, I am inclined to believe that they were more or less consciously inspired by teazious illusions on spontaneous automation, and that their efficiency no less than their advisability is very doubtful. It is certainly too soon for forming a definitive judgment and it would be premature to make a study of the practical results secured. Twelve months at least will be needed before the statistical data will be available. But it is not too late to attempt to describe the problem of the relations between foreign exchange rates and international economic equilibrium as they present themselves in the economic life of the middle of the century.

In the first decade following World War I, the data of the problem were comparatively simple. Many currencies were no longer convertible into gold, but a free market for foreign exchange was everywhere in operation with the exception of Soviet Russia. Economists were interested in the influence of the rise in foreign exchange rates on domestic prices and on the foreign trade of a single country. They were wondering whether the spontaneous fluctuations in exchange rates tended to restore the balance of foreign trade and of international payments. In the case of Governments, their chief anxiety was to restore the convertibility in gold of their currencies at a rate corresponding to that of their «natural equilibrium». Viewed from the standpoint of economic analysis, the characteristic feature of the situation then existing as compared to that of today was the simplicity of the working hypotheses: the legitimacy of exchange operations, the unity of foreign exchange rates, the atomism of transactions, the free formation of prices, the freedom enjoyed by industry, commerce and labor within the several countries and in their international relations, the uniformity of means of payments.

This theory badly needs to be reconstructed on the basis of new hypotheses. But we do not aim so high. In this paper we shall first give some explanations on the concept of international economic equilibrium. Then we shall examine whether devaluation can exert an effective influence on this equilibrium. Finally we shall submit some remarks on the expediency of devaluation. The subject is certainly no new one. But the original feature of this article will — so we believe — be that it will view the economic relations in the light of the conditions prevailing under the several regimes: planned economies, free economies, mixed economies.

1. The Several Notions of Equilibrium.

2. - In speaking of international economic equilibrium we certainly do not mean to refer to that succession of monetary equilibria between the several demands and supplies of foreign exchange that could theoretically exist in an ideally perfect exchange market (1).

...
One may then ask how all this will be settled in the long run. We certainly do not share the optimism of Keynes in whose opinion the question is one of no importance because "in the long run we are all dead". But looking to the far future we know that there are so many unforeseeable events of various kinds in the history of nations that we may well consider as possible the advent of phenomena that we cannot even imagine today, which would enable the debtor countries to settle their obligations. Who could have foreseen about 1875 that the United States, then a debtor country, would find in petroleum an important source of external revenues? Who could have foreseen the importance the rubber plantations would attain in Indo-China and the Malay peninsula? It would be foolish for us to start worrying half a century ahead.

5. — Historical experience perhaps invites us to accept as normal an equilibrium implying movements of long term capital (3) in two directions: one and over long periods. Theoretically, the movement of capital is not — or is not necessarily — a transitory element of the equilibrium; it may be a transfer of productive forces. In the 19th century European workers went to fertilise the resources of the United States; that also was a transfer of productive forces. Nevertheless, in the case of the "factor capital", a connection exists between the capital and the "capitalist" (who, as far as we can see, may be a small saver). A means must therefore be found for securing the transfer in the future of income and amortisation payments, and this necessarily implies in a more or less distant future the purchase by the creditor of goods or services, or else new loans. But just as the "labour factor" has gradually settled down and has acquired the habit of spending its income on the spot, so it is not conceivable that the "factor capital" may do likewise.

We are thus led to consider, perhaps over a period of decades, an economic balance allowing of a regular influx of capital of American origin. This economic balance, midway between the balance of payments and the balance of current transactions, would include all the truly "economic" transactions, including movements of private and public capital, and would exclude only transactions with no counterpart, of a philanthropic or political nature (4).

If one adheres to this view it is difficult to draw a distinction between private and public capital.

6. — The problem of equilibrium may be tackled with different methods. The desired recovery of equilibrium may be passively awaited as the spontaneous outcome of circumstances. Or, it may be supported by direct measures for stimulating trade (4) and credit (4), or by encouraging private investments (4), or by setting up international monetary mechanisms (4), or again by recourse to technological improvements (increased productivity). In the following pages we shall examine exclusively the role of devaluation as a reequilibrating process.

II — The Efficiency of Devaluation.

9. — One of the most significant advances made in economic science in recent years has been the reappraisal of the fiction of an "homo economicus", an abstraction moving in a void. (5) The American Government has proposed to Congress that a sort of credit insurance be organized in favor of the holders of American funds, thus guaranteeing the convertibility into dollars of gold-growing abroad (Charles Sawyer, Secretary of Commerce, in United Nations, World, January 1940, p. 58).

(3) For instance, the European Payments Union, or Mil- 
(4) See, for instance, the European Payments Union, or Mil- 

(4) See Basset, "L'appréciation de la planification", in Economia Internazionale, January, 1940.
10. — Under a fully planned economy, as now practiced and in its present stage in the Soviet Union for instance, the authorities establish physical plans for imports and exports in keeping with the general plan. The Foreign Trade Department deals with foreign countries exclusively through foreign currencies. The balance of foreign transactions depends partly on world prices, which escape almost entirely the control of the Department, and partly on the quantities bought and sold, which depend on the plans laid down as expressed in physical terms, so that variations in exchange rates should have no influence. In its dealings with the home country, the Foreign Trade Department pays in the national currency for the products it exports, and it is paid also in the national currency for the imported commodities sold to the concerns that use or distribute them. As the plans are compulsory — plans for delivery for export, plans for the use of imported products — it would be useless in theory to modify the rate of exchange with a view to encouraging or discouraging exports or imports, as the decisive factor for the internal undertakings, which are State agencies, is the plan and not the price. The Foreign Trade Department can freely detach domestic from foreign prices and can, if need, manipulate the domestic prices so as to stimulate the diversion of products for export or discourage the demand for foreign equipment.

11. — The situation would be different under a sociquest or a pseudo free economy, the classical theory supposed that free competition existed even between countries, and that the market men reacted swiftly and vigorously to price changes; hence the deduction that distribution must reduce imports, which will become too expensive in terms of the national currency, and must encourage exports. We now know that economic life is not so elastic as to secure the precise adjustments needed. Even under a free economy, technical exigencies or psychological and social inertia hinder adjustments in the structure of exchanges.

In the case of imports, the rise in the price of the American product, for instance, does not suffice to assure its replacement by a French product which perhaps does not exist (for instance petroleum). And it is difficult to find replaceable marginal products in a period when imports have already been reduced to essentials. Moreover, pressure in favor of replacing foreign imports by national goods is not exercised if the higher prices following on a variation in the rate of exchange can be charged to the home consumers. Understandings between producers or the more passive attitude of consumers, facilitate these developments, more especially in times of inflationary pressure. This leads to price rises that have a tendency to become general and spread like a contagion, preparing the ground for new monetary mishaps.

In the case of exports the important thing is to ascertain whether a price fall in terms of foreign currency following devaluation will increase the volume of sales abroad to such an extent as to increase receipts in foreign exchange. Is foreign demand elastic enough? Many studies have been made on this matter (9) but no convincing evidence have been adduced. It is far from certain that a proportional reduction of the prices of all export commodities, such as is caused by devaluation, leads to an increase in the total receipts of foreign exchange. In the case of certain products devaluation may perhaps bring about a change in the sources of supply (for instance, England purchases silk fabrics in Italy rather than in France). This is a mere phenomenon of competition, which transfers the difficulties from a neighbor, and may be offset by reprisal devaluations. To secure decisive evidence, the elasticity of the total demand of importing countries should be measured, and, for the time being, the major question is the elasticity of the American demand. It must not, however, be forgotten that devaluation also lowers the prices of those products for which there was a normal demand at former prices, and in whose case the general price fall will result only in a reduction of total receipts (10).

13. — Considering the exports of a country as a whole we shall now bring forward a few figures which will allow of comparison between French and British exports over the period 1913-1918 (see Tables I and II). The comparison is interesting as it shows us the alternate phases of the depreciation of one currency and the stability of the other, and spreads over a period of considerable length (11).

<table>
<thead>
<tr>
<th>Periods</th>
<th>France</th>
<th>Great Britain</th>
</tr>
</thead>
<tbody>
<tr>
<td>1913-1914</td>
<td>1.59</td>
<td>3.30</td>
</tr>
<tr>
<td>1919-1920</td>
<td>1.51</td>
<td>3.33</td>
</tr>
<tr>
<td>1926-1927</td>
<td>1.40</td>
<td>3.07</td>
</tr>
<tr>
<td>1929-1930</td>
<td>1.29</td>
<td>3.03</td>
</tr>
</tbody>
</table>


In the period between 1913 and 1918 the franc had depreciated in the ratio of 5 to 1, while the pound sterling had been brought back to its former parity. Much has been said of the British depression during this period, of the stagnation of British export industries and of the brilliant recovery of France. The figures, however, show alike growth of exports: 37.7% for Great Britain, 45.1% for


France. We admit that the depreciation of the franc leaves a slightly higher margin of growth to France. But this is the only case of a favorable to devaluation.

Praise has often been lavished on the devaluation of the pound sterling in 1931 while at the same time France was blamed for her absurd attachment to the gold block. Nevertheless, during the second period we find that the fall in British exports (65.7%) was almost the same as that of French exports (67.3%); if we take into account the margin of uncertainty that accompanies the figures, we find that the exports of the two countries of that which devalued its currency and of the which upheld its parity, suffered just the same fate.

The third period (34.35 to 37.38) offers a good example of the drawbacks of deprecia- tion, France, which has devalued her currency several times, sees her exports fall by 172.7% while at the same time British exports increase by 174.1%.

Let us now look at the post-war data (1938-1948). Except for a slight readjustment at the beginning of the war, the pound sterling is

stable. On the other hand, the franc falls to one tenth of its pre-war value. As compared to 1938 British exports have increased by 154.7% and French exports by 128.6%. The country which devalued lost slightly ground. The loss is much more marked from 1948 to 1948 (in January 1948 the franc suffered a serious ampu-

Table II

<table>
<thead>
<tr>
<th>Periods</th>
<th>EXPORTS FROM FRANCE AND GREAT BRITAIN</th>
<th>(millions of dollars - 1934 parity)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Great Britain</td>
<td>France</td>
<td></td>
</tr>
<tr>
<td>1938</td>
<td>6,253</td>
<td>876</td>
</tr>
<tr>
<td>1939</td>
<td>8,253</td>
<td>1,287</td>
</tr>
<tr>
<td>1940</td>
<td>1,042</td>
<td>1,977</td>
</tr>
<tr>
<td>1941</td>
<td>1245</td>
<td>1925</td>
</tr>
<tr>
<td>1942</td>
<td>375</td>
<td>112</td>
</tr>
</tbody>
</table>

Sources: International Financial Statistics. The data are comparable with those of Table 1.

14. Probably the other items of the balance — freight rates, bank and commercial commissions, tourist trade receipts, etc. — are less sensitive to exchange rates than are commodities, for they depend less on prices than on certain structural or institutional factors. To receive freight rates for oil or coal, one must have a special fleet of tankers and bunker. The receipt of insurance premiums depends on the possession of a special organization, of capital, trained staff, offices, an assured reputation, and a clientele. To receive tourists, a country must be provided with tourism agencies, roads with well-equipped petrol-stations, railways, hotels, a certain general standard of honesty, and also resorts, monuments, museums. Devaluation is not a magic wand which will command St. Mark’s Basilica to rise or will spread out a sheet of turquoise blue water between two wooded mountains.

As to the movement of capital, monetary insecurity, revealed or aggravated by devalua-

tion, is certainly not likely to encourage foreign capital investments.

15. If devaluation is ineffective under a free or quasi free economy it will be still more so under a mixed system.

The imports made under purchasing or investment plans are not affected by devaluation and could be reduced by a direct government decision. Private imports, regulated by quotas, will only be affected by devaluation if it lower the demand below the fixed quotas; but here a more rapid result would be secured by reducing the quota or raising the customs duties. As to clandestine imports (or parallel market imports) made with the assistance of a black exchange market, they are obviously unaffected by a change in the official exchange rate.

Exports arranged under bilateral agreements between governments, especially those fixing deliveries and providing preference quotas, can hardly be affected by a change in the rate of exchange. In the case of private exports, devaluation modifies the ratio between the internal and the external prices to the advantage of the latter. It affords at least an inducement to export, and if necessary to allow a reduction on prices quoted in foreign currency. Nevertheless, the administrative formalities required under a mixed economy, both in the exporting and the importing country, lead to a discouragement that devaluation often fails to overcome. In addition to this, all the difficulties arising from demand elasticity are again to the fore.

In the case of foreign capital, it is probably more affected by institutional conditions (nationalization, price control, profit control, etc.) than by the attraction of profits. Guaranteed convertibility of dividends and sinking fund will certainly do more to attract it than devaluation.

16. This analysis leads us to the general conclusion that devaluation is an instrument of mediocre efficiency in restoring economic balance. And worse still — and we shall now try to prove it — devaluation is very frequently a dangerous procedure for the country which allows itself to be caught in its toils.

III. The Inadequacy of Devaluation

17. Viewed from a national standpoint, devaluation may at times have seemed the legal recognition of a de facto situation; thus bringing to a close a phase of instability and securing a stabilization in an atmosphere of renewed confidence (case of France in 1938).

Unfortunately, since then the general atmosphere has changed. In Continental Europe at least a good part of the original stabilization of the French franc, or the mere fear of a fall, acts as itself in act as a motor which sets going psychological processes leading to harmful results. Any official variation in exchange rates is sufficient to induce traders and manufacturers to raise their prices with consent of the public; the market supply is artificially curtailed by the storing of commodities in expectation of a further rise; similar expectations stimulate demand; the trade unions ask that wages be raised; exporters delay or cancel the foreign exchange they receive. In short, devaluation leads to a reduction of the purchasing power of the currency on the home market, and this in time will lead to a further devaluation, and so on. A free economy is of course more sensitive to these phenomena than a fully planned economy, but in this respect the psychological and political atmosphere is more important undoubtedly than the differences in economic system.

Moreover, devaluation modifies the internal distribution of economic activities in favour of the industries working for exportation. A rise in the rate at which foreign currency is exchanged for national currency raises profits over night, even if the sale prices quoted in foreign exchange fall, and even if there be no increase in the total receipts of foreign bills. In other words, profits rise even if devaluation does nothing to rebalance the economy. Assuming that there be an increase in the physical volume of exports, it is by no means certain that, under modern conditions of production, this will entail a proportionate increase of employment, and it may be that the workers employed by exporting industries will fail to secure a fair share of the advantages of the devaluation. Indeed, it is to be feared that the principal result of the devaluation will be higher profits, and this is perhaps the deep-seated reason for
The Development of Export Trade of European Industrial Products and its Financing

by

PASQUALE SARACENO

1. Pre-conditions for the restoration of a more balanced western European economy.

The world economic situation is characterized by two facts:

(a) the under-developed countries have a small payment capacity and, therefore, cannot obtain adequate supplies of the equipment they need for the development of their natural resources;

(b) the countries of western Europe have attained so high a degree of exploitation of their natural resources that their only possibility of expanding their national incomes and restoring the balance of their international accounts lies in the development of their industrial production and exports.

Given this situation, if the recovery of the countries under (b) and the expansion — which goes with it — of their capacity of exporting industrial goods, does not proceed simultaneously with the development of the buying capacity of the countries under (a), the industrial investments which are being made in the industrialized European countries are an danger of remaining inadequately utilized. This situation is already making itself felt in a number of European countries and threatens to become even more serious as the present modernisation and development plans are carried out.

The rehabilitation of world economy and a rapid conclusion of the period of foreign assistance to western Europe are therefore contingent on the complementary development of the production and exportation of:

(a) industrial products, especially equipment goods, on the part of industrialized European countries;

(b) primary goods on the part of the rest of the world.

Until both these flows have organically developed, an adequate social and economic equilibrium will hardly be attained. Some European countries will remain chronically in a debtor position toward some of their trade partners and in an equally chronic creditor position toward others; stocks of unsold goods will accumulate, production capacity will remain partly unutilized, unemployment will tend to increase and any mechanism of multilateral compensation, however cleverly contrived, will prove inefficient as long as the unbalance of international exchanges will find its cause in permanent production insufficiencies.