Exchange Rate Structure and Price Levels in Italy: 1947-48

by

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1. *Purchasing power parities.* — The disorderly conditions prevailing in the Italian foreign exchange market are the common inheritance of war and of monetary inflation. Broadly speaking, the most striking maladjustments in the post-war period were: *a*) the development of a multiplicity of rates applying to a greatly diversified pattern of international transactions, *b*) the wide fluctuations of exchanges in the free markets, and *c*) the disparity between price levels and exchange rates in Italy and abroad (1).

The quickly depreciating exchanges and the successive official devaluations of the lira resulted, directly or through an expansion in the volume of money supply, in steeply rising internal prices. The confused conditions prevailing on the Italian foreign exchange market have often distorted foreign trade relations or have resulted in windfall profits or severe losses for some categories of importers or of exporters, notwithstanding official controls. Italian exporters often clamoured for a currency devaluation in order to improve their competitive position in the world markets. The transition from a seller's to a buyer's market has added to the existing difficulties, making devaluation even more tempting.

It may be of interest to make a retrospective examination of the Italian foreign exchange structure and of the internal price level during 1947 and the first half of 1948 with a view to showing the degree of inter-relationship existing between these two important elements of the economy. The foreign exchange reform, adopted at the end of November 1947, is considered here as a landmark along the road to the establishment of less abnormal conditions because a remarkable integration and rationalization of the exchange structure was thereby achieved.

(1) The Allied Forces on landing in Italy established the official lira rate at 100 lire to one dollar and 400 lire to one pound sterling. To reduce disparities in price levels exporters were paid, under a decree issued on 18 January 1946, an equalization fund quota amounting to 125 per cent of the official rate which was, at the same time, charged to importers. A few months later, the 50 per cent system was instituted (under a decree issued on March 26, 1946) for trade with countries not linked to Italy by a trade and payments agreement. Later, the 50 per cent system was adopted also with respect to some payments agreements, such as those concluded with Turkey and Portugal. Under this system, exporters and other recipients are permitted to sell half of their exchange proceeds, within specified time limits (at first 90 days, later 60 days), at the rate they can get from authorized importers. The other half is to be surrendered to the Exchange Control Office (*Ufficio Italiano Cambi - Italcambi*) at its official buying rate. Italian traders quickly organized a foreign exchange market where dollars, pounds sterling, and Swiss francs were regularly traded. Only some specified commodities could be imported under this system. They are set out in two lists: list A comprising goods for which no import permit is needed, and list B comprising goods for which an import licence is necessary. The average return to the exporters corresponded to the average between the official rate and the free rate quoted in the 50 per cent foreign exchange market. This average rate constantly overvalued the lira. It became soon necessary to devalue the official rate in August 1947 from 100 to 350 lire to one dollar and, with respect to some exporters, to raise the percentage of receipts available to them (90 or 95 per cent for ship-builders, 75 per cent for wool manufacturers, etc.).

All these measures proved inadequate. On November 28, 1947, certain far-reaching measures were adopted. They can be briefly summarized as follows: The Italcambi buying rate is the average of the free quotations during the preceding month (including, for the dollar, quotations exceeding 650 lire or less than 350); all provisions favouring specified groups of exporters are abolished; available balances unsold after a period of 60 days are to be surrendered to the Exchange Control Office at a 20 per cent discount. In this way the foreign exchange structure attained a higher integration and fluctuations in exchanges were kept within moderate limits.

Throughout this article, to avoid misinterpretations, the following terminology has been consistently applied:

a) *Official rate*: until August 3, 1947, 100 lire to one dollar. Devalued to 350 lire on August 3, 1947;

b) *Italcambi buying rate*: rate at which 50 per cent of proceeds are surrendered to the monetary authorities;

c) *Import rate*: free rate quoted in the 50 per cent foreign exchange market;

d) *Export rate*: the average between the import rate and the Italcambi buying rate;

e) *Black market rate*: for illegal transactions;

f) *Clearing rates*: adopted in the settlement of clearing transactions.

However, an appraisal of trends must be based on a standard of evaluation, which, for the purpose of this article, will be found in the purchasing power parities calculated on the basis of the wholesale price levels in Italy and in certain foreign countries. The choice of these parities as the spectrum against which to evaluate the fluctuations of actual rates does not imply that they correspond to the equilibrium rates, *i.e.* those which would maintain the balance of payments in equilibrium. No one would, in the present highly distorted conditions, speak of equilibrium in Italian foreign trade relations. These rates are adopted as a standard of reference in evaluating the changing economic position of importers or of exporters, on the assumption that these rates would have secured to them more competitive conditions less conducive to windfall profits, disturbing losses, trade deviations, and speculation. In the examination hereunder the level of the rates actually applied to foreign trade transactions will be constantly compared with the purchasing power parity rates. The calculation of parities was made both with respect to the dollar and the pound sterling because: *a*) these were by far the most important currencies in which Italian foreign trade transactions were settled, and *b*) the disorderly behaviour of the pound sterling-dollar cross rates has added to the disturbed situation.

Table I shows the p.p.p. rates for the dollar and the pound sterling in each month of 1947. The assumptions on which the calculation was based and the methods adopted are briefly described in note (a) to Table I.

2. *The multiple foreign exchange structure in 1947.* — The importance of each single rate within the multiple foreign exchange structure in 1947 may be gauged on the basis of the percentage relationship of the value of transactions to which similar rates applied to total trade. This estimate may also be helpful for

LIRA-DOLLAR AND LIRA-POUND STERLING PURCHASING POWER PARITIES IN 1947 (a) TABLE I

Months	Wholesale Prices: Italy (1938=100) (b)	Wholesale Prices: U.S.A. (1938=100) (c)	Ratio a/b	Lira-Dollar P.P.P. (lire per dollar)	Wholesale Prices in Great Britain (1938=100) (c)	Ratio a/e	Lira-Pound Sterling P.P.P. (lire per sterling)
	a	b	c = a/b	d = c × 22.62	e	f = a/e	g = f × 102.16
1947 Jan.	3754	180.02	20.87	472	180.20	20.83	2129
» Febr.	3892	183.96	21.19	479	181.19	21.47	2091
» March	4139	190.33	21.75	492	182.19	22.72	2321
» April	4539	187.91	24.16	546	185.15	24.52	2505
» May	5203	186.90	27.84	630	187.13	27.80	2840
» June	5329	188.04	28.34	641	188.12	28.33	2894
» July	5779	191.85	30.12	681	191.10	30.24	3089
» Aug.	5889	195.42	30.14	682	192.08	30.66	3132
» Sept.	6202	199.85	31.03	702	193.07	32.12	3281
» Oct.	5991	201.85	29.71	672	197.03	30.41	3107
» Nov.	5651	202.89	27.85	630	200.99	28.12	2873
» Dec.	5456	207.50	26.29	595	201.98	27.01	2759

(a) The calculation of purchasing power parities for 1938 assumes the existence of a perfect equilibrium of actual rates and prices in 1929, *i.e.* approximately a year after stabilization of the lira (1927). The choice of a base year so far back may be criticized as well as the choice of wholesale price indices calculated in different countries on the basis of different groups of commodities. However, this has appeared to be the least uncertain statistical method for an approximate determination of a standard of evaluation for the study of actual rates. The B.I.S. in its annual report states on this point:

"In judging what would be the true rate of exchange of a currency use must be made of several indices—not only of the commodity price index but also of indices showing changes in cost of living, wage rates, notes in circulation and even the total of the national income—not forgetting the attention which may have to be paid to structural changes. The calculation of purchasing power parities on the basis of wholesale prices is, however, the simplest method of approaching the problem, and if the necessary reservations are borne in mind, such calculation may form a useful starting point". Federal Reserve Bulletin, October 1947, p. 1247.

Taking 1929=100, the Italian index number of wholesale prices stood in 1938 at 97.76, the U.S. index at 82.48 and the U.K. index at 88.79. By multiplying the quotient of the Italian and U.S. price indices (1.185) by the lira-dollar rate of exchange in 1929 (19.09 lire per dollar), we obtain the p.p.p. rate for 1938 of 22.62 lire to one dollar. By the same method the lira-pound sterling p.p.p. rate was calculated at 102.16 lire per sterling. As shown in the table above the calculation of parities for 1947 was based on these two 1938 parities.

(b) Index of the Central Institute of Statistics, Rome.

(c) Indexes from the *Federal Reserve Bulletin*.

an appraisal of the competitive position of different categories of importers, or of exporters, and for an understanding of the existing maladjustments. In order to arrive at such an estimate it will be necessary to arrange the complicated pattern of foreign trade transactions into homogenous categories with identical or similar rates. A study of rates of exchange not based on this classification would present a picture far removed from reality; the conclusions drawn would in all likelihood be erroneous or incomplete.

For the following principal categories of transactions, similar or identical rates were adopted:

Import trade: *a*) Government purchases and foreign grants; *b*) bilateral compensation arrangements; *c*) "franco valuta" or imports free of exchange; *d*) clearing agreements; *e*) imports under the 50 per cent foreign exchange system.

Export trade: *a*) bilateral arrangements such as barter and reciprocal transactions, and clearing agreements; *b*) exports under the 50 per cent foreign exchange system.

Table II shows the importance of each of these categories as a percentage of total import and export trade, respectively, in 1947.

TABLE II

ITALY'S IMPORTS AND EXPORTS IN 1947 BY CATEGORIES OF TRANSACTIONS WITH IDENTICAL OR SIMILAR RATES OF EXCHANGE

Categories	as a per cent of total: Imports	Exports
Government transactions	28.9	0.1
Free grants (UNRRA, AUSA)	18.2	—
Private barter deals (a)	10.1	19.1
Reciprocity deals (b)	0.6	3.5
Franco valuta (c)	7.8	1.2
Clearing	6.9	9.4
50 per cent foreign exchange system (d)	16.2	60.3
Sundry	11.3	6.4
Total	100.—	100.—

(a) See note (2); (b) see note (2); (c) see note (3); (d) see note (1).

Source: Table II is based on data obtained from various sources and then elaborated. Owing to the difficulty of correctly estimating Italian foreign trade movements, and to the lack of reliability of official statistics, the percentages shown are rough approximations designed to give an idea of the order of magnitude involved. Total Italian imports in 1947 are estimated at 1,509 million dollars, exports at 768 millions.

3. *Government purchases and foreign grants.* — The data contained in Table II are only rough approximations, but sufficiently reliable for the purpose of this study. It appears that in 1947 about 47 per cent of total Italian imports were State purchases or free grants supplied by international relief organizations (UNRRA) or by the United States (AUSA). For about half the volume of commodities imported, therefore, the internal price structure was entirely divorced from the impact of fluctuations in rates of exchange or in prices abroad.

With respect to the prices of these commodities, some of which are key products — coal, wheat, petrol —, the importance of the foreign exchange policy is practically nil. Attention should rather be focussed on the price fixing policy adopted by the Government or by the international relief organizations (UNRRA).

The rate would in this case correspond to the ratio of prices, *i.e.* the ratio between prices expressed in the foreign currency and prices fixed for the sale of the goods in Italy: two elements which have varied extensively during the period under review for each single commodity. A study of these price ratios, necessarily confined to essential commodities, would show that they were considerably lower than the equilibrium rate (p.p.p. rate). Throughout the year a constant effort was made to bring these specific rates in line with the equilibrium rates by upward revisions of the sale prices fixed for these commodities.

The policy of setting low prices for State imported or for donated commodities had two important results, viz. *a*) the upward pressure of prices was curbed, *b*) badly needed commodities could be purchased at favourable prices. This would not have been possible in a large number of cases had the price ratio been more in line with the equilibrium rate.

Some unfavourable results should, however, not be overlooked, such as: *a*) the gains accruing to certain groups of importers charging prices that were adjusted to the wholesale commodity price level; *b*) the inflationary pressure on the price level deriving from the subsidy thus paid by the State to importers. Advantages and disadvantages should be the object of a careful analysis before passing judgment on this general policy. This examination concerns, however, the general price fixing and price control policy and necessarily remains outside the scope of this short survey. While recognising the need for a gradual re-adjustment of the domestic price structure, no one should overlook the advantage of bringing these specific rates into line with the equilibrium rate, as the strict control on prices is gradually relaxed.

4. *Bilateral arrangements* (2) — The prices of commodities imported through private barter and reciprocal transactions are also unaffected by the foreign exchange policy adopted by the Government. It emerges from Table II that such imports made up about 11 per cent of total imports in 1947. Rates adopted in the conversion from prices expressed in foreign currency into lire, have varied in accordance with the specific price ratios for the commodities exchanged.

A detailed examination of the specific rates adopted in these negotiations would carry us too far. Broadly, however, it can be stated that there was a certain degree of similarity between these rates and the equilibrium rate of exchange approximately determined on the basis of purchasing power parities. Excessive gains occasionally reaped by operators in these markets, who profit by the disparity between specific rates and equilibrium rates, will gradually lose importance with the ironing out of divergencies in the increase from pre-war levels recorded by the prices of single commodities and by the wholesale price levels, respectively, in the two trading countries. Although, therefore, these bilateral transactions may have offered the opportunity for windfall profits they have also been helpful in fostering the re-adjustment of the price structures in the two trading countries, by bringing single prices more into line with the general price level. If textiles command a high price in Sweden, where they are in scarce supply, and a low price in Italy, where they are plentiful, and if the opposite is true for cellulose, the exchange of the two commodities may cause an adjustment of these prices to the general level of prices in Italy and in Sweden.

5. *"Franco valuta" (imports without allocation of foreign currencies)* (3). — A number of Italians had undeclared credits abroad or succeeded in building up large balances in foreign currencies by evading foreign exchange regulations. Undeclared receipts from exports and purchases in the black markets were the chief sources of these illegal balances. In order to favour the repatriation of this flight capital, the Italian Government has permitted "franco valuta" imports. In 1947 the commodities imported under this system are estimated to have amounted to about 8 per cent of the total import trade. The dollar or the pound sterling black market rates can be taken to represent the conversion rate for commodities thus imported. In other words, credits or foreign exchange balances will be utilized only when the specific rate for the commodity to be imported (ratio of Italian prices to prices abroad) is higher than the black market rate. The specific rate for each commodity will correspond to the equilibrium rate when the prices of each particular commodity in the two countries are adjusted to the general wholesale price level. Structural disparities in price systems may explain the convenience of effecting "franco valuta" imports even when the black market rate is at the same level or even higher than the equilibrium rate. In January 1947 when the p.p.p. of the dollar amounted to 472 lire to one dollar as against a black market rate of 606 lire, it may still have been profitable to import some commodities (for instance, tobacco), the price of which had risen from pre-war less than the general price index in the U.S.A. and more in Italy. As trade is intensified, such discrepancies are gradually levelled off; the "franco valuta" system has probably made a contribution to the adjustment of disparities in price levels in Italy in addition to favouring the repatriation of flight capital.

As shown in chart I and Table III the spread between the *dollar black market rate* and the p.p.p. rate in the early months of 1947 was gradually narrowed during the second half of the year. Till about July 1947 the dollar black market rate maintained a higher level than the corresponding equilibrium rate, which proves that on the whole "franco valuta" imports were not profitable, except for products commanding in the two countries prices markedly out of line with the equilibrium levels. Later, the blak market rate fell below the equilibrium rate, which shows the advantage of importing under the system in question.

A large number of imports was in fact made during the latter part of 1947, which not only favoured a reduction of price differentials and the repatriation of balances illegally held abroad, but also relieved the upward pressure of prices in Italy. The liberalization of controls with respect to this form of trade is but one of the measures adopted by the Italian Government in order to stabilize the internal purchasing power of the lira. Needless to say that the foregoing remarks on the convenience of importing under the "franco valuta" system are of general nature and their actual importance is greatly limited by the strict controls and hindrances to which this system of trading is subjected.

TABLE III

P.P.P. AND BLACK MARKET EXCHANGE RATES
(Lira-Dollar and Lira-Pound Sterling) (a)

Months	Dollar (in lire)		Pound Sterling (in lire)	
	Black market	P.P.P.	Black market	P.P.P.
1947 Jan.	606	472	1691	2129
» Febr.	590	479	1718	2091
» March	644	492	1820	2321
» April	722	546	2046	2505
» May	801	630	2315	2840
» June	738	641	2139	2894
» July	666	681	1955	3089
» Aug.	637	682	1804	3132
» Sept.	665	702	1699	3281
» Oct.	646	672	1608	3107
» Nov.	584	630	1453	2873
» Dec.	582	595	1416	2759

(a) Black market quotations are monthly average quotations in the Rome market.

CHART I

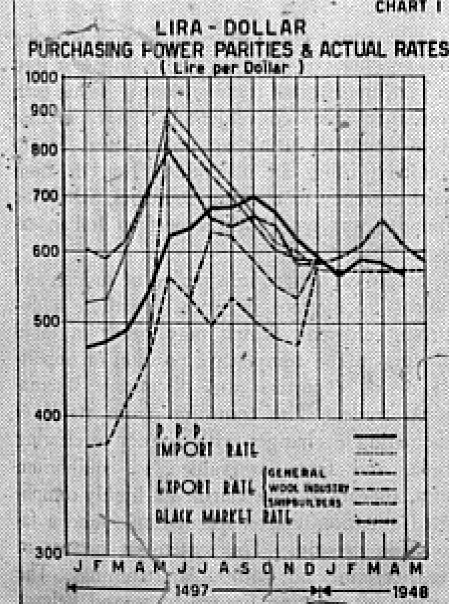
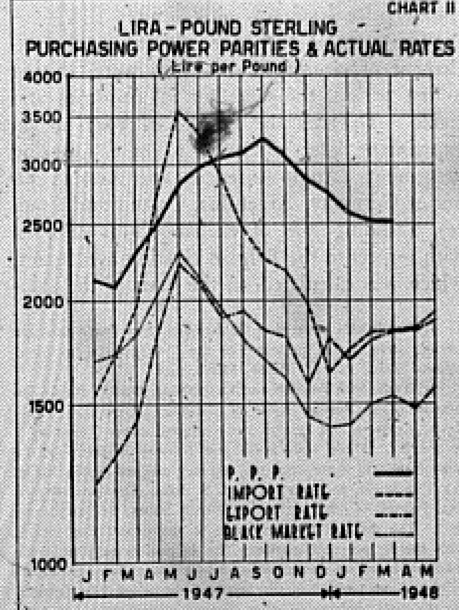


CHART II



(2) Reciprocal transactions are a form of trade based on the exchange of commodities with payments effected by importers to exporters in their local currencies through special accounts set up in the Official Exchange Control. Private barter deals are actual exchanges of commodities of equal value and can take place also between countries not linked by a trade and payments agreement. Reciprocal transactions will only be allowed with countries that have concluded a reciprocity trade agreement with Italy.

Italian trade with Austria and Czechoslovakia is conducted exclusively through barter transactions. Trade with Greece, Hungary, Sweden, Bulgaria, the Netherlands and Denmark took the form of reciprocity transactions only; similar transactions are permitted in the trade with Norway, Spain, Switzerland.

(3) "Franco valuta" imports are allowed in specific cases when the importers undertake not to ask for an allocation of foreign currency and not to open credits in Italy to the foreign suppliers. These imports may represent utilization of credit balances held abroad before March 26, 1946 or free donations to Italian citizens.

The *pound sterling black market rate* maintained throughout 1947 a lower level than the comparable equilibrium rate. Theoretically, therefore, the convenience of importing from the sterling area under the "franco valuta" system needs no further demonstration. In practice the flow of such imports has never been substantial; the undervaluation of the pound in the Italian black market may have been in part a result of the impossibility of effecting such imports on the scale that purely economic reasons would have suggested. Stringent export restrictions in the U.K. and the difficulty of obtaining import licences in Italy, explain the disparity between price levels and exchange rates in Italy and in the U.K. (4).

6. *Trade under clearing agreements* (5). — In 1947 the foreign exchange policy adopted by the Government directly affected prices only with respect to commodities imported from countries linked to Italy by a clearing agreement or for imports under the 50 per cent foreign exchange system. The value of imports in the former case did not exceed 7 per cent of the aggregate value of all imports and amounted to 16 per cent in the latter case. This shows that the influence of actual rates quoted in the foreign exchange market on the domestic price level was only limited.

The rates of exchange adopted in the settlement of clearing transactions were, during a first period, the same for all countries and stable. Towards the middle of 1947, as an experiment later extended to other clearing agreements (Anglo-American and Russian zones of Germany, Argentima, Poland and France), a sliding rate of exchage was adopted with respect to the Belgian clearing agreement, which was calculated on the basis of the average dollar export quotation during the previous month, or fortnight, etc. Table IV shows the average dollar cross rates for the principal clearing rates to facilitate comparisons. The same rate of exchange applies to both imports and exports under clearing agreements. During the first half of 1947 all clearing rates markedly overvalued the lira and their level was considerably lower than the equilibrium level. Since the volume of such imports was only a modest percentage of total import trade in 1947, it may be safely assumed that the restraint placed by the low rate on the rise in the internal price level was only very slight. It is more likely that the sale prices of these commodities were in the home market adjusted to the general wholesale price level, which indicates that importers from clearing countries may have been the only ones to profit by the overvaluation of the lira. The rapid exhaustion of available clearing quotas, the pressure to secure import licences and the excess of imports over exports are further proofs of this distorted situation. In fact, during the first half of 1947, the over-valuation of the lira with respect to clearing trade, corresponded to the payment of a subsidy to importers. Large payments in gold or in hard currencies had also to be made in order to settle the substantial clearing overdraft.

The considerable spread between clearing and equilibrium rates has also resulted, at least in part, in distorted trade relations. It has been constantly more convenient to divert purchase from countries using an undervalued lira to countries using an overvalued lira, or from hard currency to clearing countries, while the opposite was true with respect to Italian exports.

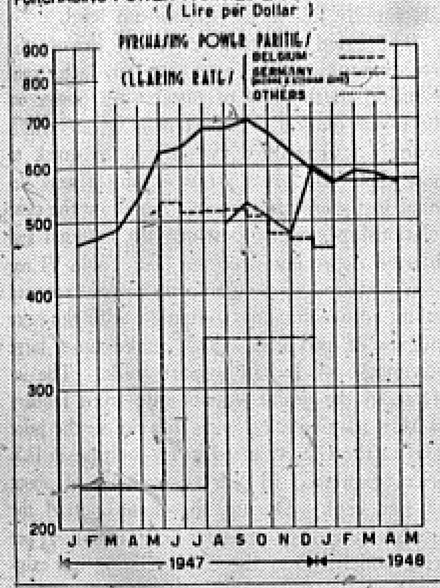
Stable exchanges in a period of sudden and violent fluctuations in prices constitute a disturbing element, which may result in rapid changes in the competitive position of importers or of exporters and discourage international trade. The transition from stable to fluctuating exchanges with respect to clearing trade, and from overvalued to equilibrium rates, appears to have clarified a highly complicated situation where speculation found a favourable ground. The system at present in use is certainly not without shortcomings. The method of adopting French franc and Belgian franc rates calculated as a dollar-cross-rate does not eliminate the influence of disparities between price levels and exchange rates in the U.S.A. and in the "soft" currency areas. It has often happened that the clearing rate has valued the lira below the equilibrium level or below the black market rate, so that the previous situation was completely reversed. Italian exports became profitable, imports from clearing countries were discouraged and bilateral trade relations were again unbalanced.

(4) See in this connection Guido Carli, *Our Trade with the Sterling Area* (report presented to the "Conference on International Trade Policy" Rome, March 1948).

(5) Trade with Belgium and Luxemburg, France, the Anglo-American and Russian zones of Germany, Argentina, Yugoslavia, Rumania and Poland was conducted under "clearing" agreements. Trade with Spain and Norway is partly in the same form. In some cases the currency adopted is the Italian lira (Yugoslavia, Rumania) or the U.S. dollar (Germany, Argentina, Poland) or other currencies (French francs, Belgian francs, etc.). The dollar rate corresponds to the export rate quoted with the 50 per cent market. The Belgian franc rate is the cross-rate based on the lira-dollar export rate and on the dollar-Belgian franc parity. Similar systems are adopted in calculating the rates applying to other clearing agreements.

CHART III

PURCHASING POWER PARITIES & CLEARING RATES
(Lire per Dollar)



The continuous overvaluation of the lira with respect to clearing trade during 1947 and the more balanced conditions prevailing at the end of the year clearly appear from the comparison of clearing rates with equilibrium rates in Table IV. The effort made by the Government to narrow the wide gap between these rates was slow and required lengthy experiments in order to avoid sudden shocks to the economic system.

7. *Imports and exports in free exchange.* — In March 1946 the Italian Government permitted exporters to sell on the open market 50 per cent of their receipts of some foreign currencies—U.S. dollar, pound sterling and Swiss franc—with the provision that the foreign balances available should be used within a specified period of time for the import of essential commodities. In this way a foreign exchange market was soon organised where these currencies were freely quoted (6). This system can be considered a first attempt to conduct foreign trade on a multilateral basis; the rates quoted in this market are those on which attention is usually centred. In fact, the rates adopted in settling these transactions are important not only because this form of trading made up a high percentage of the total volume of Italian foreign trade during 1947 (about 60 per cent of exports and 16 per cent of imports), but also because these rates may offer a rough indication of what would be the equilibrium rate if all restrictions were removed. These free rates are indeed adopted as a basis for the establishment of the clearing rates.

An examination of developments in 1947 in the 50 per cent foreign exchange market must necessarily be preceded by some important distinctions. It is above all necessary to keep the *dollar area* and the *sterling area* sepa-

TABLE IV

P.P.P. AND CLEARING RATES OF EXCHANGE
(lire per dollar)

Months	P.P.P.	Exchange rates with European countries		
		Belgium	Germany (Anglo-American zone)	Other (a)
1947 Jan.	472	225	—	225
» Febr.	479	225	—	225
» March	492	225	—	225
» April	546	225	—	225
» May	630	225	—	225
» June	641	534	—	225
» July	681	518	—	225
» Aug.	682	520	500	350
» Sept.	702	522	535	350
» Oct.	672	508	508	350
» Nov.	630	484	483	350
» Dec.	595	476	603	350

(a) For instance, Denmark, Holland, Sweden, Norway and France.

(6) The dollar, pound sterling and Swiss franc can be quoted; at present some other currencies such as the Egyptian pound and Portuguese escudos are also admitted to the free market.

rate because of the inconvertibility of the pound sterling throughout 1947, with the exception of a very short period. Moreover, a distinction should be made between (*a*) the *import rate of exchange, i.e.* the price demanded by exporters or holders of balances in foreign currencies for sale to importers, and (*b*) *the export rate*, which is the average between the Italcambi (Italian Foreign Exchange Control) buying rate for the part surrendered and the import rate for the freely transferable portion. The percentage available to exporters, as a rule, corresponded to half the proceeds, except for certain commodities during a short period when it rose to 75 or 95 per cent.

A. Table V compares *the dollar and pound sterling import rates* with the p.p.p. rates.

Table V

DOLLAR AND POUND STERLING: P.P.P. AND "IMPORT" RATES OF EXCHANGE

Months	Dollar (in lire)		Pound Sterling (in lire)	
	P.P.P.	Import rate	P.P.P.	Import rate
1947 Jan.	472	528	2129	1532
» Febr.	479	532	2091	1713
» March	492	604	2321	1975
» April	546	698	2503	2706
» May	630	906	2840	3576
» June	641	842	2894	3330
» July	681	775	3089	2919
» Aug.	682	723	3132	2479
» Sept.	702	667	3281	2269
» Oct.	672	619	3107	2194
» Nov.	630	603	2873	1984
» Dec.	595	576	2759	1637

A'. Table V (*see Chart I*) shows clearly that up to August 1947 the *dollar import rate* maintained a higher level than the equilibrium rate; subsequently it fell slightly below it. To understand the factors making for the exceptional instability of the dollar import rate it must be borne in mind that:

— in practice this market is far from free. The demand for foreign exchange is limited by the small number of commodities that can be freely imported or by the number of licences granted.

— the varying degree of liquidity of the money market and the marked changes in market psychology were responsible for the disorderly fluctuations recorded by these rates.

During the early part of 1947 the high degree of liquidity of the money market added to the strong demand for imports from "hard currency" areas (other sources of supply being scarce) in causing a marked depreciation of the lira. The dollar import rate of exchange rose high above the equilibrium level. Later, largely as a result of the restrictive credit policy adopted in September 1947 and of the "falling price mentality" thus created in the Italian markets, and in part as a result of the greater possibility of obtaining supplies from other areas (from countries linked to Italy by bilateral agreements, etc.), the dollar import rate rapidly fell to its equilibrium level.

The rapid depreciation of the lira on the free exchange market was a serious factor contributing to the loss of purchasing power on the home market. Importers at a rate which strongly undervalued the lira were quick to raise their sale prices, thus adding a new element to the inflation cycle. To show the close relationship existing between the external and internal depreciation of the lira, Table VI has been prepared. U.S. wholesale prices expressed in lira equivalents are compared with the price indexes of products which make up a large percentage of Italian import trade. The increase in the dollar import rate from January to May 1947 coupled with the rise in the price level in the U.S. resulted in an increase in U.S. prices expressed in lira equivalents of about 78 per cent. During the same period the prices of imported products rose in Italy 73 per cent, which shows the close relationship existing between fluctuations in the import rate and the price level of imported products. The decline in the dollar import rate during the following period resulted in a 35 per cent fall in the U.S. prices in lira equivalents; the prices of products imported by Italy declined during the same period by only 19 per cent, which proves that internal prices are "sticky" in the downward adjustment.

The marked depreciation of the lira during the first part of 1947 (January-June) placed in an exceptionally profitable position importers from clearing countries or those purchasing State-imported commodities; in fact their rates overvalued the lira while their sale prices were more or less adjusted to the general price level.

Table VI

U.S. PRICES EXPRESSED IN LIRA EQUIVALENTS

(1938 = 100)

Months	U.S.A. wholesale prices (index)	Import rates of exchange		U.S.A. prices expressed in lira equivalents	Index numbers of the wholesale prices of imported commodities (b)
		rates	Index numbers (a)		
	a	b	c	d = a×c	f
1947 Jan.	180.0	528	2334.2	4202	5434
» Febr.	184.0	532	2351.9	4327	5672
» March	190.3	604	2670.2	4981	6158
» April	187.3	698	3085.8	5780	7113
» May	186.9	906	4005.3	7486	9417
» June	188.0	842	3722.4	6998	9747
» July	191.9	775	3426.2	6575	9753
» Aug.	195.4	723	3196.3	6246	9316
» Sept.	199.9	667	2948.7	5895	8800
» Oct.	201.7	619	2736.5	5520	8659
» Nov.	202.9	603	2665.8	5409	8346
» Dec.	207.3	576	2546.4	5284	7869
1948 Jan.	210.7	573	2533.2	5337	7783
» Febr.	202.5	573	2533.2	5130	7630

(a) Based on 1938 = 100; adopting an equilibrium rate for 1938 of 22.62 lire to one dollar (see note (a), Table I).

(b) Indexes compiled by the "*Centro per la Statistica Aziendale*" of Florence.

A'. The maladjustment was even greater for the *pound sterling import rate* (see *Chart II*). After a short period when sterling was convertible into dollars and the import rate roughly coincided with the equilibrium rate, the import rate fell (August 1947) to a point far below the equilibrium level. Table V shows in fact that the general tendency of the pound sterling import rate was to sink to a level far below the equilibrium point. The period April-June 1947 was one of artificial overvaluation of sterling which resulted from a clause in the agreement concluded between Italy and the U.K. in April 1947 whereby the Italian Government undertook to guarantee that the pound sterling-dollar cross-rate in the Italian market would correspond to the official parity (4.03). After the suspension of convertibility this clause was no longer respected and sterling recorded a marked depreciation.

The undervaluation of the pound sterling in the Italian free exchange market is a direct result of the post-war Italian surplus in current transactions with the U.K. Commodities in short supply in Italy could with difficulty be obtained from that market. Those who succeeded in importing from the sterling area were, throughout most of the year, in a very favourable position. It is unlikely that the cheap imports from the U.K. resulted in a general advantage by curbing the rise in the domestic price level. It is much more probable, in view of the relative importance of these imports in the general framework of trade, that the internal sale prices of these commodities were adjusted to the general price level, so that the profit from sterling devaluation was reaped almost wholly by importers.

After the foreign exchange reform of last November the gap between actual import rates and equilibrium rates is noticeable with respect to the pound sterling. The new trade agreement between Italy and the U.K. in January 1948 providing for an expansion of Italian imports from that area, strengthened sterling rates in the Italian free market. Even now, however, the margin between import and equilibrium rates is very wide.

B. Table VII (see *Charts I and II*) compares the *dollar and pound sterling export rates* with the purchasing power parities. It is not necessary to dwell on the importance of these rates which apply principally to Italian exports to the dollar and sterling areas. In 1947 more than half the total volume of exports was effected under the 50 per cent foreign exchange system, to an almost equal extent in dollars and in pounds.

These rates are naturally under the impact of the same forces as the import rates since they are the average between the latter and the Italcambi buying rate. The changing policy of the foreign trade authorities in granting import licences, the changing psychology of the market which can make it convenient to sell available balances more or less hastily, the changing conditions of market liquidity, are all factors which influenced during the course of the year under study the behaviour of import, and consequently, of export rates. In addition, the fluctuations in the export rate may also reflect changes in regulations with respect to the proportion of proceeds which is to be surrendered to the monetary authorities, revisions of the official or Italcambi buying rate or changes in the time limits within which the balances are to be surrendered or utilized, etc.

These conditions varied extensively during 1947 and culminated in the new foreign exchange system of last November.

TABLE VII

DOLLAR AND POUND STERLING: P.P.P. AND "EXPORT" RATES OF EXCHANGE

Months	Dollar (in lire)				Pound Sterling (in lire)	
	P.P.P.	Export exchange rates: normal (50%) (a)	wool manufact. (75%) (a)	ship building (90/95%) (a)	P.P.P.	Export exchange rate
1947 Jan.	472	376	376	376	2129	1219
» Febr.	479	378	378	378	2091	1310
» March	492	414	414	414	2321	1441
» April	546	461	461	461	2505	1806
» May	630	566	566	872	2840	2241
» June	641	534	534	811	2894	2128
» July	681	500	638	748	3089	1913
» Aug.	682	536	630	704	3132	1945
» Sept.	702	508	588	651	3281	1840
» Oct.	672	484	552	606	3107	1802
» Nov.	630	476	470	590	2873	1581
» Dec.	595	589	589	589	2759	1810

(a) See note (1).

B¹. A study of the movement during 1947 of the *dollar export rate* suggests the following observations: *a*) the export rate remained constantly below the equilibrium level; *b*) the rate recorded disorderly fluctuations; *c*) after the adoption of the foreign exchange provisions of November 1947 the export rate rose to the equilibrium level.

The conditions prevailing up to December 1947 deeply affected the position of Italian exporters. The widely fluctuating rate was an element of continuous uncertainty in the calculation of costs and proceeds and a serious hindrance to international trade relationships. The constant overvaluation of the lira harmed Italian exports to the dollar area. Except for cases of marked divergency between single prices and the wholesale price levels, Italian exporters had either to raise their prices expressed in dollars, thus harming their competitive position on the U.S. market, or had to be satisfied with smaller returns from their exports than they could obtain on the domestic market.

Because of the exhaustion of the possibilities offered by the "seller's market" various measures were taken to relieve the deteriorating position of Italian exporters (see note (1)), such as the devalution of the official rates in August 1947, the granting of a larger proportion than 50 per cent of proceeds to some exporters and, finally, the measures of November 28, 1947, whereby the Italcambi buying rate was increased to the average level of the import rate quoted during the previous month.

Chart I and Tables V and VII show that these measures resulted in a remarkable unification of the previously maladjusted levels of the dollar import, export and equilibrium rates. Shortcomings which in 1947 had impaired Italian international trade were in large part eliminated, *i.e.* (*a*) the overvaluation of the lira with respect to export trade, (*b*) the widely fluctuating exchanges, (*c*) the divergence between import and export rates.

These provisions do not appear to have had the inflationary results which normally accompany devaluation. The increase in the monetary circulation caused by the rise in the Italcambi buying rate did not result in a further rise in the domestic price level thanks to a simultaneous reduction in the velocity of circulation. It is true that an expansion in export trade may cause a shortage of goods on the home market and therefore rising prices; however, the devaluation was not very noticeable; it benefited only exporters to the dollar

TABLE VIII

INDEXES OF PRICES OF ITALIAN FINISHED PRODUCTS EXPRESSED IN U.S. DOLLAR EQUIVALENTS

Months	Prices of Italian industrial finished goods for export (a)	Lira-dollar export exchange rate: lire per dollar	Lira-dollar export exchange rate: index (1938 = 100) (b)	Italian prices in U.S.A. dollar equivalents (index)	U.S.A. wholesale prices (index)
1947 Jan.	4808	376	1662	289	180
» Febr.	4820	378	1671	288	184
» March	4978	414	1830	272	190
» April	5134	461	2038	252	188
» May	5291	566	2502	211	187
» June	5749	534	2361	243	188
» July	5818	500	2210	263	192
» Aug.	5730	536	2370	242	195
» Sept.	5990	508	2246	267	200
» Oct.	5952	484	2140	278	202
» Nov.	5690	476	2104	270	203
» Dec.	5332	589	2604	205	208

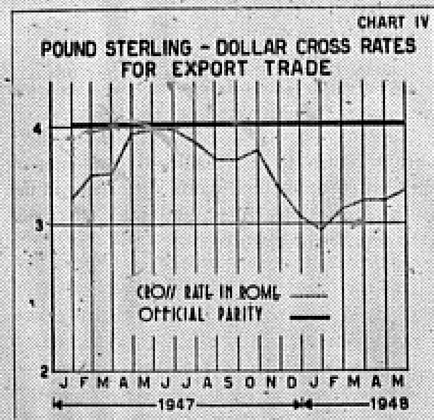
(a) Index calculated by the "*Centro per la Statistica Aziendale*", Florence.

(b) Based on a theoretical purchasing power parity for 1938 = 22.62 lire per dollar (see note (a), Table I).

area and in all likelihood did not result in a marked revival of Italian export trade.

Table VIII, comparing the price indexes of finished products exported by Italy, expressed in dollar equivalents, with the U.S. wholesale price index, may help to show the disparity between price levels in Italy and in the U.S. in 1947. The indexes of Italian prices of exported finished products were recently calculated by a statistical research office of Florence (*Centro per la Statistica Aziendale*). A comparison of the data in the last two columns of Table VIII shows that during 1947 the dollar prices of Italian products had risen from 1938 much more than the price level in the U.S. In December 1947, after the foreign exchange reform, a remarkable adjustment of Italian prices in U.S. dollar equivalents to U.S. wholesale prices was achieved.

B². The same improvement was not realized with respect to the *pound sterling export rate*



(see *Chart II*). The large Italian export surplus in trade with the U.K. resulted in a strong undervaluation of this rate (7). It is true that the commodities chiefly exported by Italy to the U.K. are sold in Italy at prices which have risen from pre-war less than the general wholesale price level so that exports can even be effected at a rate that slightly overvalues the lira. However, exporters to the U.K. have been at a disadvantage compared with exporters to other markets, using a less overvalued lira. This situation, which remained almost unaffected by the new foreign exchange system of last November, preoccupied Italian monetary authorities and in January 1948 an agreement was concluded with the United Kingdom providing for an increase in the volume of imports from that area; this has already resulted in a hardening of pound sterling quotations and in an improvement of the position of Italian exporters.

Table X and Chart IV show the depreciation of the pound sterling in terms of dollars in the Italian market during 1947. The pound sterling-dollar cross-rate was at the official parity level only in April, May and June 1947, *i.e.* when the pound sterling was supported by the Italian Foreign Echange Control. Later, after the suspension of convertibility, the sterling cross-rate fell rapidly to a low point of 3.07 dollars in December 1947.

TABLE IX

POUND STERLING-DOLLAR CROSS-RATES FOR EXPORT TRADE IN ITALY

Months	Pound Sterling export exchange rate (lire)	Dollar export exchange rate (lire)	Sterling-Dollar "export" cross-rate	Sterling Dollar official parity
1947 Jan.	2229	376	3.24	4.03
» Febr.	1310	378	3.47	4.03
» March	1441	414	3.49	4.03
» April	1806	461	3.92	4.03
» May	2241	566	3.96	4.03
» June	2128	534	3.96	4.03
» July	1913	500	3.83	4.03
» Aug.	1945	536	3.63	4.03
» Sept.	1840	508	3.62	4.03
» Oct.	1802	484	3.72	4.03
» Nov.	1581	476	3.32	4.03
» Dec.	1810	589	3.07	4.03

8. *Recent trends and conclusive remarks.* — The statistics used in this study permit us to draw certain conclusions. It emerges clearly that during the course of 1947 substantial progress was made towards the removal of existing disparities and maladjustments between price levels and exchange rates. In fact: *a*) the foreign exchange control became more flexible with a large scope for monetary management; *b*) the multiple foreign exchange structure, often the source of unjust profits, unforeseen

(7) For further details on this point see Guido Carli, loc. cit.

losses, distortion of trade, was replaced by a nearly unified system; *c*) freely quoted rates were in part removed from the disturbing influence of changing market psychology (particularly serious when a forward market on exchanges is lacking); *d*) a fair adjustment was reached between actual and equilibrium rates.

The equilibrium between rates and prices reached during the latter part of 1947 has been maintained up to the moment of writing (May 1948) as shown in Table X. A wise monetary policy and a skilful control of the exchange market, especially with respect to the dollar and pound sterling import rates which are the pivots of the whole system, should be inspired by the necessity of maintaining and improving this equilibrium. It is obvious that foreign exchange and foreign trade controls can be entirely abolished only when the equilibrium of the Italian balance of payments is restored. Until then, a balanced system of prices and rates will greatly depend on the efficiency of controls. The goal of an automatic equilibrium is still distant. In the short run the main problem is that of adopting suitable foreign exchange and foreign trade policies designed to avert a return to the disturbed conditions of 1947, when unjustified gains, distortions in the cost and price structures, and trade diversions were prominent features.

TABLE X

LIRA-DOLLAR AND LIRA-POUND STERLING RATES OF EXCHANGE IN THE FIRST MONTHS OF 1948

Months	U.S.A. Dollar (in lire)					Pound Sterling (in lire)				
	Italcambi buying rate (a)	Import rate	Export rate (b)	Black market rate	P.P.P.	Italcambi buying rate (a)	Import rate	Export rate	Black market rate	P.P.P.
1947 Jan.	576	573	574.5	592	570	1637	1755	1696.0	1422	2383
» Febr.	573	573	573.0	613	591	1736	1837	1795.0	1501	2541
» Mar.	573	574	573.5	662	586	1838	1839	1838.5	1573	2328
» April	574	575	574.5	618	573	1840	1851	1843.5	1484	2469
» May	575	575	575	587	561	1851	1947	1899.0	1572	—
» June	575	—	—	—	—	1947	—	—	—	—

(a) For compulsory sales (50 % of export receipts) to the Italian Exchange Office (*Ufficio Italiano Cambi*) (see note 1).

(b) A cross-rate based on the dollar "export" exchange rate is adopted for the transactions with the main countries with which clearing agreements are in existence.