

TRADE RELATIONS BETWEEN
FREE-MARKET AND
CONTROLLED ECONOMIES

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PREFACE

One of the major problems of commercial policy likely to arise after the war is that of the trading relationships between countries if some subject their foreign trade to direct regulation and others desire to avoid such controls and to influence the free play of the price mechanism only or mainly by tariffs. Towards the solution of this problem, war-time experience can contribute little, as the external trade of almost all countries is now strictly controlled. The most appropriate approach to the problem clearly lies in an analysis of the difficulties with which countries maintaining a substantially free trading system and relying primarily on the tariff method of trade regulation were faced in the 1930s owing to the growth of quotas, exchange control, government monopoly and other types of trade regulation elsewhere and in a critical appraisal of the attempts made to meet these difficulties.

Such a task has been undertaken in this study by Professor Jacob Viner, who in his last chapter of conclusions, however, supplements his appraisal of past policies by constructive proposals for the future.

This volume constitutes part of a programme of studies devoted to problems of postwar economic policy. Other volumes in the same series, dealing with various aspects of the problem of future international trading relationships, include *Europe's Trade*, *The Network of World Trade*, *Commercial Policy in the Inter-war Period: International Proposals and National Policies*, and *Quantitative Trade Controls: Their Causes and Nature*. Reference should also be made to the report of the League of Nations Delegation on Economic Depressions on *The Transition from War to Peace Economy*, the third chapter of which deals, *inter alia*, with postwar commercial policy and allied questions.

The publication of Professor Viner's study as a valuable contribution to thought on the subject of postwar commercial policy does not, of course, identify the League of Nations with the analysis and views contained in it.

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Our thanks are due to the Rockefeller Foundation which has generously supported the work involved in the preparation of this volume.

A. LOVEDAY,

Director of the Economic,
Financial and Transit Department

League of Nations

June, 1943

I. INTRODUCTORY

It is the purpose of this memorandum to deal with the problems of commercial policy which arise for any particular country which does not, and does not wish to, subject its foreign trade to direct regulation when other countries important in its foreign trade relations do subject the foreign trade transactions of their nationals to direct regulation.

No country permits its foreign trade to be conducted wholly free from government regulation. The devices by which a government can influence its country's foreign trade are many and varied in character, and there is some difficulty, both in theory and in practice, in drawing a sharp line between "direct" and "indirect" regulation. For the purposes of this memorandum, foreign trade transactions will be regarded as free from "direct" regulation if the potential importer is free to make his decision as to whether to engage in the transaction on the basis of consideration only of the prices of the commodities concerned abroad and at home, of transportation costs, of exchange rates common to all, and of ordinary import duties, if any, applicable uniformly to all importers from the particular foreign country involved; or in other words, if the transactions are governed only by so-called "free market" considerations. Conversely, an import transaction will be regarded as subject to direct regulation if either (or both) of the two following conditions is *not* met: (a) any person within the country is free to import the commodity concerned, in any quantity and from whatever region, without the requirement of specific permits or licenses which are not freely available; (b) any importer of the commodity concerned can freely buy foreign exchange for use in payment of such import either in an open market or from exchange authorities at exchange rates uniform for all buyers.

The criterion used here in determining the existence or non-existence of "direct regulation" is whether or not official authorities limit in any direct way the foreign trade operations of *particular* traders. There are three principal devices by which countries can in this sense directly regulate their foreign trade on a comprehensive scale: exchange control, import quotas, and direct governmental conduct of foreign trade (i.e., state monopoly of foreign trade, and state-con-

ducted trade where individual traders are formally left free to carry on foreign trade transactions on their own account but the state has created or permitted to exist conditions with respect to prices, tariffs, subsidies, privileged cartels, exchange rates, and so on, which leave no basis, or only a negligible basis, for profitable transactions by individuals on their own initiative).

Exchange control may not involve direct regulation of trade in the sense followed here. It does involve direct regulation of trade only if there are under it restrictions and rationing with respect to the disposal of foreign-exchange receipts arising out of current export transactions, and to the purchase of foreign exchange for the purpose of making payments for current or prospective commodity imports. As a rule, the use of exchange control for purposes of direct regulation of trade involves the setting up, unilaterally or by negotiation, of clearing arrangements, which may be regarded as instrumentalities for the application of exchange control. Import quotas always involve some measure of direct regulation, although the degree of direct regulation would be slight if the quotas were global, without differentiation of source of import or identity of importer, and were allotted either on a strictly chronological basis or by lot or auction. In general there would be in practice a substantial identity between control of trade by "direct regulation" and "quantitative" control of trade through the allocation of exchange, through import quotas, or through direct government conduct of foreign trade.

This memorandum is concerned with the problems of commercial policy that countries which in general desire to conduct their foreign trade on the basis of a free-market system encounter in their trade relations with countries which practice exchange control for trade regulation purposes, or which apply import quotas extensively, or which conduct a substantial portion of their foreign trade as a government monopoly.¹ Since an obvious, and not obviously an erroneous,

¹ The only significant types of what might be regarded as direct regulation of foreign trade not covered by these three categories are some of the practices usually designated as "indirect protection" or "administrative protection" and especially the control of imports through "sanitary" regulations or through arbitrary *ad hoc* administrative valuations of imports for customs purposes, including the application of "antidumping duties." Such measures could be conceivably carried to such an extent as to be a practical equivalent of a system of comprehensive exchange control or of import quotas. In the 1930's, for example, Canada made extensive use of arbitrary values in the assessment of *ad valorem* import duties as a means of regulating the volume—and perhaps also the source—of imports. While no revealing official account

answer to the question of how free-market-system countries can best conduct their trade relations with the outside world when that world is largely or even predominantly operating under systems of direct regulation of trade is that they also should adopt one or the other of these systems, I have felt it necessary to devote some space to an explanation of the rise of these systems and to an examination in general terms of how they have worked both for the countries following them and for the countries adhering to the free-market system. No attempt will be made, however, to give an account of the many sub-types of direct regulation systems, or of their impact on particular countries, and historical material will be used only to provide background and occasional concrete illustration for the analysis here presented.

II. EXCHANGE CONTROL

REASONS FOR ITS RISE

As will be explained, when exchange control is practised by any country for any purpose, it tends to be used also as an instrument of trade regulation, and when it is embarked upon by some countries it tends to spread to other countries. Realistic discussion of the problems which the use by some countries of exchange control as an instrument of trade regulation creates for countries which do not themselves practise or desire to practise exchange control calls therefore for objective consideration of the conditions which operate to make its use attractive to any country and for any purpose.

Beginning with the onset of the great depression, country after country adopted, either on a partial or on a comprehensive basis, the exchange-control method of regulating its commercial relations with other countries, and by 1939 a substantial portion of the aggregate

has ever been given of the principles which governed these valuations, it is possible that they were so applied as to be in practice the equivalent of a comprehensive system of import quotas. No attempt will be made here to cover these borderline phenomena. Wartime trade controls, for military or economic warfare purposes, will also be omitted from the discussion.

Governments in recent years have delegated to national cartels having agreements with foreign cartels, or have permitted such cartels to take over, some of their traditional functions of trade regulation. Such arrangements will not be dealt with specifically in this memorandum. They are instances of "direct" and "quantitative" regulation of foreign trade. While formally at least the regulation is by non-governmental agencies and the problem is one of private monopoly in international trade, in substance the amount of government influence or supervision may be such as to make it approach closely the problem of government monopoly in foreign trade.

volume of international trade was subject to it. It appears to be true that at no time from 1931 to 1939, except for parts of 1935 and 1936, were abandonments or abatements of exchange control as important in the aggregate as new introductions or extensions thereof. With the coming of the Second World War, there was a further wide extension, for war purposes, of exchange control, and today its practice is very nearly universal. So widespread an adoption of the practice must have been due to weighty causes, given its administrative burdens and inconveniences and its sharp break with free-market traditions.

The most important single factor to be taken into account in an explanation of the rise of exchange control is that this rise came during a period of extreme world-wide depression, of a virtually complete breakdown of international credit facilities, and of the progressive collapse of the international gold standard. In most cases of the original establishment of exchange control, the primary purpose was to protect the existing gold or exchange value of currencies which were under extreme pressure as the result of the departure by other countries from the gold standard, of extreme exchange-depreciations in other currencies, of sharp falls in the world-market price levels of raw materials and foodstuffs, of new trade barriers, and of the unavailability of credit assistance from outside sources. On the continent of Europe in particular there was an almost pathologically extreme determination to maintain, at whatever cost, the official gold values of the national currencies because of the memories of the havoc which had resulted from the extreme inflations following the first World War.¹ In some cases resort had already been made to other devices than exchange control as a means of supporting the currency, such as

¹ It has been suggested also that another consideration was important in leading some countries to choose exchange control in preference to exchange depreciation. Suppose for instance, as was the situation of many countries, that a particular country, A, has heavy export balances with one set of countries, the "B" countries, and heavy import balances with another set of countries, the "C" countries, and suppose that the B countries impose severe restrictions on imports from this country, or block the proceeds from its export sales, or require their use for the liquidation of outstanding financial liabilities. Exchange depreciation by A will provide no remedy for its unsatisfactory trade relations with the B countries, for even if it should lead to increased exports to these countries this would not be to its interest in the absence of the ability to find in these countries sources of the kinds of imports it needs or to get free currencies in exchange for its exports. Exchange depreciation also will not help it in dealing with the C countries, for these countries are by hypothesis not a good market for its exports. An exchange control making possible differential treatment of these two groups of countries will thus appear to provide a more effective remedy for A's difficulties.

increased ordinary tariffs or new emergency tariffs, import quotas, and induced price deflations. But these other devices had either failed adequately to relieve the pressure on the exchanges, or had intensified or appeared to intensify the severity of the depression and especially of unemployment. In any case, they appeared to many countries to be too cumbersome, too indirect, too slow, uncertain and inflexible in their mode of operation, to be suitable devices for dealing with a problem whose character and intensity were subject to frequent change. Direct control of the foreign exchange market seemed to them under these circumstances to be the most appropriate way of protecting the gold (or exchange) value of a national currency at least cost to the national economy. By requiring that acquisitions of foreign exchange be turned over for disposal to the control agency at rates fixed by it, by prohibiting or limiting through a license system the export of capital, by restricting the use by foreigners ("blocking") of their holding of domestic balances, and, most important for the purposes of this memorandum, by limiting through import licenses or by withholding foreign exchange the commodity and service import transactions which operate to increase the supply of domestic funds on the foreign exchange markets of other countries or to deplete the national holdings of foreign funds and of gold, it was hoped that the gold and gold-standard-currency values of the national currencies could be maintained without involving deflationary pressure on the internal price-structures.

In most of the countries adopting exchange control the official value of the currency in terms of gold or of foreign gold-currencies was higher or was believed to be higher than could be maintained if exchange control was applied only to capital transactions (new export of capital, liquidation of outstanding external indebtedness, interest service on outstanding external indebtedness). The scope of their exchange controls was for this reason, as well as because it was difficult to protect any exchange control against serious evasion unless it was applied to all or to most important categories of foreign exchange transactions, extended by many countries so as to apply to purely commercial transactions. For our purposes the significant feature of such exchange controls was that they involved allocation by government authorities among various classes of applicants of a supply of foreign exchange which at the official rate was smaller than the demand and that they thus involved direct regulation of foreign trade.

In a number of countries, adherence to a pre-existing gold standard or to previous exchange-parities was formally maintained, while in fact a large part—sometimes the predominant part—of international transactions with gold-standard countries was conducted on the basis of a depreciated-exchange-value for the national currency. The procedures followed fall into two broad classes. Some countries set up an officially recognized multiple currency, under which there were different categories of national currency, having a uniform value but varying legal tender properties in the internal market, and having different values in the foreign-exchange markets, with one of the categories preserving, in form at least, the full pre-existing gold-parity. Other countries maintained a pre-existing gold- (or exchange-) parity for the official national currency, but either openly permitted an unofficial but legal and recognized foreign-exchange market to operate, on which the national currency was sold in exchange for foreign currencies at rates substantially below the official rates, or tacitly permitted a non-legal “black market” to operate on the basis of freely-fluctuating exchange rates. Maintenance of different rates for the national currency, however, necessarily involved some measure of control of exchange transactions, since otherwise no one would surrender foreign exchange at the official rate and it would be impossible to maintain supplies of foreign exchange at the official rate sufficient to supply the demand. While at first the measures of control of exchange transactions might be limited to non-commercial transactions, the tendency everywhere was to extend them to commercial transactions proper. The multiple-currency device or the officially-tolerated black market was in some cases intended to limit the scope of direct control or was a stage in the process of abolition of exchange-control. In other cases, however, these seem to have been historically an incident of incomplete evolution of comprehensive exchange control, and to have been destined to disappear with full development and enforcement of the exchange-control system. But even where there was a free “black market,” exchange control involved direct regulation of foreign trade if there was allotment for commercial purposes of any foreign exchange at the low official rates and if there were requirements for the turning over to the exchange control at the low official rates of any portion of the foreign exchange proceeds of exports, and if the formulae for allotment and requisition

of foreign exchange at the low official rates involved differential treatment of countries, commodities, or persons or firms.

EXCHANGE CONTROL AS AN INSTRUMENT OF MONOPOLISTIC
TRADING

It is a familiar principle of economic theory that wherever any commodity (or group of commodities) is offered for sale competitively by a number of independent individual sellers to a number of independent individual buyers the terms of sale will not be as favourable to the sellers as a group as would be the most favourable terms available to them if all the sellers acted in concert while the buyers continued to act individually.¹ A well-known extension of this principle is that the potential gain to the sellers from acting monopolistically will be maximized if the sellers operate as a discriminating monopoly, that is, if the sellers, acting in concert, classify the potential buyers as far as is practicable according to the degree of elasticity with respect to price of their demands, and demand different prices of each class of buyers, the lower the elasticity of demand the higher being the price demanded. Corresponding principles apply to the behaviour of buyers, according as they act individually or monopolistically.

Applied to foreign trade, this means that in theory at least the terms on which any country trades with the outside world when its exporters and importers operate individually can be improved upon from the national point of view, (a) if the exporters act as a monopolistic unit, or (b) if the importers act as a unit; and will be at their optimum if both exporters and importers, respectively, act as units, and if foreign buyers and foreign sellers are dealt with in separate groups, and are offered different terms of purchase or sale, according to the elasticities of their demands or supplies, provided in each case that the foreign buyers or sellers continue to act individually.

In theory, these advantages of monopolistic selling and buying, including the additional advantages of discriminating monopoly, can be exploited by the ordinary methods of import and export duties, including discriminatory duties as between different countries. This is the element of truth in the century-old concession of even free-

¹ Except for the limiting, and under actual circumstances inconceivable, case where the aggregate demand for the commodity has infinite elasticity with respect to price. In this case the sellers can derive no advantage from operating monopolistically.

trade economists that in theory tariffs can be used to national profit to improve the "terms of trade" with foreign countries provided these other countries do not retaliate. But exchange control, potentially at least, offers a technically more satisfactory instrument for this purpose in at least three respects :

(1) Because exchange control necessarily involves administrative discretion, it is more amenable to frequent adjustment to conform to changes in conditions than are tariffs set up by statute. The difference between the two tends to diminish where the customs authorities have been given administrative discretion to modify import duties at will. But in countries with democratic procedures there is everywhere a marked jealousy on the part of the elected legislature with respect to authority over the tariff, whereas exchange control must by its very nature be administered under discretionary authority, and as a new institution (if pre-seventeenth-century parallels be not invoked) is free from the inhibitions on discretionary administration such as those which are imposed in the tariff field by traditional legislative jealousies.

(2) Discrimination in the tariff field cannot readily be carried beyond differentiation between broad categories of commodities and differentiation between countries of origin. Commitments in outstanding treaties and the likelihood that overt discrimination in tariff rates as between different countries of origin will arouse foreign resentment and deliberate retaliation are obstacles to open discrimination between countries in import duties, while tariff discrimination through fine classification of commodities is a laborious and somewhat inflexible procedure, especially if it must be carried out through the regular legislative process. Under exchange control, on the other hand, the machinery by which the available supplies of foreign exchange are allocated, day by day, to applicants lends itself readily to as fine a discrimination between countries, categories of commodities, and categories of importers or foreign exporters as is wished.

(3) Exchange control provides, under some circumstances at least, a more effective instrument for trade bargaining with foreign countries than does ordinary tariff-bargaining. There is, first, the greater administrative flexibility of exchange-control procedures than of tariff procedures. Second, it is easier to avoid troublesome publicity under exchange control than under ordinary tariff bargaining. Exchange-control agreements, even if made public, are less amenable to

interpretation and appraisal by interested parties than are tariff agreements. There are no technical obstacles, moreover, to keeping exchange-control agreements secret, whereas tariff agreements, both by tradition and by practical necessity, must be made public. Traders in the countries involved must know in advance what duties their shipments will be subject to,¹ and this in practice requires publication of the effective rates of duty. Imports also can as a rule be entered, and cleared for customs, at a large number of ports, and therefore a large number of customs officials must be instructed as to the rates of duty applicable, whereas exchange control can be centralized in a single office, and thus secrecy as to the rules governing its administration can be effectively maintained. The nature of trade agreements under exchange control is such, finally, that while there may be practical certainty on the part of all concerned that discrimination is being practised, there are no unambiguous, clear, and rational criteria as to its existence or non-existence, or as to the meaning of "equality of treatment," under exchange control. It is for all of these reasons, therefore, possible under exchange control to make discriminatory arrangements with other countries with less danger of arousing resentment or deliberate retaliation on the part of the countries subjected to adverse discrimination than would be the case with tariff agreements.

The more important a country is in world trade, the greater, other things equal, the potentialities of national gain from skilful application of monopolistic principles in its trade relations with any particular other country, especially if that other country continues to operate on non-monopolistic principles. This incidentally helps to explain the more marked development in Germany than in other countries of deliberate use of monopolistic methods in the trade relations with outside countries. It also, unfortunately, provides a new rational economic argument from the national point of view for political aggression in order to bring the trade policy of outside areas under control, provided the new area need not be treated for internal purposes on equal terms with the controlling area.

¹ It would be more accurate to say that it would be very difficult for them to operate if they did not know. It could not be said in the 1930's that either an exporter to Canada or a Canadian importer could know in advance and with certainty, within a very wide range, what effective rate of import duty would be assessed in the case of any particular shipment, although it is to be presumed that there was not day-to-day variation in the effective rates on any specific category of imports.

The foregoing discussion is not presented as an argument in favour of the use of exchange control as an instrument of regulation of foreign trade in accordance with monopolistic principles. All that it purports to do is to concede that if a country wishes to regulate its foreign trade in accordance with monopolistic principles, exchange control is a much more effective instrument for that purpose than are ordinary tariffs, and to point out that there is here a partial explanation of the growth of trade regulation by means of exchange control in recent years, especially in Germany. The practical possibilities of national gain for particular countries from the conduct of foreign trade on monopolistic principles, and the consequences of such practice for the world economy, are examined in a subsequent section of this memorandum.

EXCHANGE CONTROL AND NATIONAL ECONOMIC PLANNING

Countries committed to comprehensive economic planning on a national scale, involving direct intervention in the processes of the market and state control of the allocation of at least a major part of the national supply of productive resources for production, must find some way of controlling foreign trade so that their plans shall not be subject to continuous disruption through unanticipated fluctuations in the prices and/or quantities of particular categories of imports and exports resulting from external factors beyond their control. Administratively the simplest methods, and also the most effective methods, of insulating the internal price structure and the production plans from external influence would be either wholly to suppress foreign trade or to set up a complete state monopoly of foreign trade transactions. But these methods are for most countries politically too revolutionary and recognized to be economically too costly to be attractive. Countries committed to comprehensive economic planning on a national basis therefore seek some method whereby, without resort either to drastic suppression of foreign trade or to the establishment of a state monopoly of foreign trade, not only the internal price level but also the internal structure of *relative* prices can be insulated from short-run external influences not subject to their control. A comprehensive system of exchange control can be so administered as substantially to accomplish this objective. Countries committed to comprehensive economic planning on a strictly national basis and involving direct interference with market processes thus may be expected to be

committed also to exchange control, if not to state monopoly of foreign trade, for there is a genuine economic incompatibility between a policy of free play to price factors in international economic relations, on the one hand, and a policy of direct price and quantity regulation of the national economy in its internal aspects, on the other hand. There is probably also a psychological incompatibility. Just as belief in the virtues of the free market in general tends to result in an irrational prejudice against governmental activity in any field, so probably would general belief in and widespread practice of governmental direction of industry and trade on a strictly national basis tend to foster the notion that freedom of individual activity in any economic field from direct government regulation is inherently perverse or antisocial. If national economic planning on a comprehensive scale and involving direct regulation of internal trade persists, we may be sure that exchange control will persist, unless it gives way to outright state monopoly of foreign trade.

THE TENDENCY OF EXCHANGE CONTROL TO SPREAD

An attempt has been made above to give a realistic explanation of why a country may adopt exchange control as an instrument of commercial policy, especially if it has already adopted it for more restricted monetary reasons. An explanation will now be offered of why the adoption by some important country or countries of exchange control as an instrument of commercial policy tends to lead to its adoption by still other countries.

It is theoretically quite possible, other countries permitting, for a single country to practise exchange control as an instrument of commercial policy, even if no other countries practise it, without any agreements, formal or informal, with other countries, and with maintenance of a stable exchange value for the national currency. But this would involve passive acceptance of whatever volume of exports the course of trade would bring except as modified by a system of official export subsidies, and very careful allocation of foreign exchange to importers in accordance with the yield of foreign exchange from exports. Unless the country had a large stock of foreign exchange in reserve, this would mean that importers could not be assured in advance of the availability of foreign exchange, and the ordering of commodities from abroad would have to wait until after foreign exchange had accumulated in the control's hands from the proceeds

of earlier exports. Such a system would be likely to work badly both from the exporters' and from the importers' point of view. Since in the absence of trade bargaining with other countries the exchange-control country is in some respects at a special disadvantage, whereas the centralization of control over trade and the flexibility which exchange control makes possible are a possible source of special advantage in trade bargaining, almost all countries which have used exchange control as an instrument of trade regulation have also tried to make systematic use of it as an instrument of trade bargaining. In so doing, exchange-control countries have operated to spread the practice of exchange control. Free-exchange countries tended also to deal unfavourably in their tariffs with exchange-control countries, whether fortuitously, or as retaliation against the practice of exchange control, or because the divergence of trade methods was an obstacle to the negotiation of trade agreements between them. There was thus an additional incentive to exchange-control countries to try to induce free-exchange countries also to adopt exchange control.

A more important obstacle to a flourishing export trade by exchange-control countries with free-exchange countries was the fact that in almost every case exchange control had originally been established to protect a legally overvalued currency against depreciation with respect to gold or to gold-currencies, and the currencies of the exchange-control countries continued to be overvalued in terms of relative prices; except for their national specialties, therefore, it was difficult for the exchange-control countries without resort to subsidies, or to the use of multiple currencies, to market their products in the free-exchange countries, and thus to procure the exchange necessary to buy the needed products of those countries. Exchange-control countries therefore had strong incentives to seek to persuade other weak-currency countries, and especially countries with whom they had unfavourable balances of payments, to enter into payment, or compensation, or barter agreements with themselves, and thus to obtain wider markets for their exports and a wider range of possible sources of import of needed commodities where payment need not be made in "strong" currencies or gold. The countries committed to exchange control thus were anxious to secure the transfer of as many countries as possible from the free-exchange to the exchange-control category.

There were special factors associated with the early practice of

exchange control by Germany, the leading, though not the pioneer, practitioner thereof, which tended to make other countries quite willing to enter into special clearing or compensation agreements with Germany on a mutual exchange-control basis, and for a time made them satisfied on the whole with the outcome for them of these arrangements.

In its early stages, the Nazi régime laid great stress on the virtues of "autarky," or self-sufficiency, and it did in fact energetically promote the development of internal production of materials, such as petroleum, synthetic rubber, and textile fibres, of vital military importance and whose availability by import could not be relied upon in case of war. But as economic recovery progressed in Germany under the stimulus of the rearmament programme and full employment of German productive resources was being approached, the Nazis were astute enough to realize the special unsuitability for German purposes of the traditional mercantilistic stress on exports as the valuable aspect of foreign trade, and to realize that for Nazi Germany at least the only primary economic function of foreign trade was to make imports available, and that imports were highly desirable so far as they consisted either of goods of direct military importance or of goods for non-dispensable civilian use and were such as either could be procured at less cost in terms of scarce German productive resources if obtained in exchange for German exports instead of being produced at home or were not obtainable at all through domestic production. Since Germany, moreover, was acutely short of the currencies of the free-exchange strong-currency countries, and these countries were for the most part unwilling to trade with her on a barter or bilateral basis, she was impelled to look elsewhere for the necessary raw materials and foodstuffs of which the free-exchange strong-currency countries had been the normal sources of supply.

Countries producing, or able to produce, the commodities falling within these important categories found, therefore, to their gratified surprise, that Germany, unlike the usual situation in trade negotiations, and especially at a time when a large part of the world was still suffering from depression and markets for exports were hard to find, was primarily interested in increasing her imports rather than her exports, was interested in promoting her exports chiefly in order to find the means for financing her imports, and was quite willing to permit her imports to increase without a corresponding increase in

her exports whenever other countries were willing to provide these imports in exchange for restricted mark balances. As is now apparent, Germany was not only importing for current consumption, but was building up stockpiles for the war she was planning. The attractiveness of the German market for the weak-currency countries was still further increased, at first, by the German willingness and even anxiety to take greater quantities than Germany herself had use for, either for current consumption or for stockpile purposes, of commodities which were suitable for re-export to third countries, and especially free-exchange countries. These commodities Germany planned to exchange, directly or indirectly, for commodities of a kind wanted by her but not obtainable from countries with which she had clearing or barter arrangements.

For the goods meeting the specifications noted above, Germany thus became a very receptive market. In the first phases of her exchange control, the German market was attractive to some countries not only because of the quantities which she was prepared to take, but also because she was willing to make advance purchase commitments on a large scale and thus to facilitate advance planning of production in the assurance of a market for the final output. There was also at first considerable satisfaction with the price-terms Germany offered. In her clearing agreements, Germany sought acceptance of a high rate of exchange for the Reichsmark, which made the prices received by exporters to Germany in terms of their own currency very satisfactory. The same procedure, of course, operated to make the prices of German exports in terms of foreign currency high in relation to prices in free-exchange countries. But since the countries entering into trade agreements with Germany were ordinarily not required to take specified amounts of German goods, and Germany was quite willing to give restricted marks instead of goods in exchange for her imports, the high prices of German exports were not a check to increased exports to Germany as long as the exporting countries were willing to tolerate the indefinite accumulation of mark balances to their credit. Even when these countries began to be disturbed by the accumulation of mark balances, their methods of dealing with this problem were, at least at first, generally such as not to check seriously the flow of their export products to Germany. By tightening the restrictions on imports from countries other than Germany, and especially from free-currency countries, by accepting increased quantities

of German military supplies and other commodities for government use, and by promoting preferential purchase by government agencies and others of German commodities, they increased the power of their countries to absorb German goods. The German trading methods, moreover, tended to operate favourably for the export industries of these countries even if unfavourably for their import industries and for their consumers, and the former were often much more powerful politically and much more able to force policy to fit their desires than were the latter. Some of these countries made strenuous efforts not to get too far into the bilateralistic trade trap, or, having gotten in, to escape from it again, and to increase the proportion of their trade with free-exchange countries, and there were some instances of substantial success in this direction. The net trend, however, seems to have been, for the world as a whole, for the proportion of foreign trade carried on subject to one or another direct control to be a growing proportion of total world trade.

As the number of countries using exchange control as an instrument for the direct regulation of foreign trade increased, and especially as the tendency of exchange-control countries to enter into clearing and other agreements with each other of a strictly bilateral character gained momentum, countries outside the system found themselves at an apparent disadvantage in certain respects: (a) Creditor countries within the system were able to obtain fuller liquidation of their claims on financial account from debtor countries within the system than were creditor countries outside the system. (b) The interest which creditor countries within the system had in fostering imports from debtor countries within the system as a means of obtaining payment of their claims led them to give preferential treatment to imports from debtor countries within the system as compared to imports from countries, including debtor countries, outside the system. (c) Countries within the system found it preferable, other things equal, to buy from other countries within the system rather than from countries outside the system, since in the former case imports did not involve payment in strong currencies and were more likely to give rise to compensating exports. This tended to move the terms of trade between exchange-control and free-exchange countries adversely to the latter, although the fact that countries within the system chose, other things equal, to market their export commodities in the free-exchange countries rather than in countries within the system, in order

to obtain stocks of the strong currencies, did tend to operate in the opposite direction. For all of these reasons, there was a marked tendency for countries outside the system either to enter unreservedly into it, or to adopt measures which involved substantial departure from the essential principles of the free-market, free-exchange system.

Finally, some countries with a strong currency and with no desire to depart with respect to their trade and their monetary arrangements as a whole from free-market principles saw advantages for themselves in pressing some other countries to use their exchange controls as instruments of direct regulation of their foreign trade or otherwise to abandon the free-market principle. If a country, *A*, with a strong currency has normally an unfavourable balance of trade with an exchange-control country, *B*, it may demand, under threat of restricting imports into *A* from *B*, that *B* reserve some specified portion of its receipts of, or command over, *A* currency, or of other free currencies, for use in payment of imports into *B* from *A*, or for use in payment of principal and interest on outstanding indebtedness of *B* to *A*. A country, *A*, which does not practice direct regulation of its own foreign trade may thus use the threat of its adoption and application in a manner adverse to country *B* to induce country *B* to resort to the direct regulation of its foreign trade in a manner favourable to country *A*.

GENERAL ADVANTAGES AND DISADVANTAGES OF EXCHANGE CONTROL AS AN INSTRUMENT OF TRADE POLICY

The foregoing explanation of the rise of exchange control as a trade-regulatory device shows that it has attractions for a country which finds it difficult to market its exports but is in urgent need of imports, and that its adoption by some countries increases its attractiveness for other countries which still conduct their trade on the free-market basis, and especially if they have a weak currency and an unfavorable balance of trade. The very fact that it has spread so widely within the last decade is indeed sufficient demonstration that it appeared to have important advantages to offer (although not, of course, that it had them in fact). Many persons have concluded from this that the use of exchange control as an instrument of policy is here to last indefinitely and that it is desirable that it should last, although perhaps with reform of some of its less attractive features.

Proper appraisal of the system, however, calls for more searching examination, and especially for careful formulation of the real issues involved. As a preliminary to such formulation, the following points deserve consideration:

(1) The initiation and spread of exchange control took place in a particular historical setting. Were there special circumstances operating at the time which made exchange control in general, and its use as an instrument of commercial policy in particular, attractive, but whose prevalence in the future, at least in anything like the same degree, should not be taken for granted?

The period of the 1930's, when the use of exchange control both as a monetary device and as an instrument of trade regulation became common, was obviously not a normal period. Certain adverse factors were present, if not for the first time, at least in hitherto unprecedented degree, which operated to make the world receptive to methods of conducting international economic relations which it would have summarily rejected in earlier years, and which offered substantial justification for the adoption of such methods at least to tide over an emergency period. These factors have already been surveyed above. The most important ones may be summed up as: mass unemployment at home in the early years; fear of or planning for war in the later years; overvalued currencies which were not devalued openly because of the fear of inflation; the breakdown of the international credit system; the growth of authoritarian economic planning on a strictly national basis. It may be conceded at once that if any one of these conditions (for a possible exception with respect to the last, see later) is widely prevalent in the post-war world, direct regulation of foreign trade by exchange-control methods, or by other methods perhaps even less desirable *per se*, will also be widely prevalent. It does not seem profitable to discuss the principles by which international trade relations should be governed in the post-war world except on the assumption that in the post-war world economic order there will be concerted effort: to prevent mass unemployment, to remove the basis for fear of war and to prevent deliberate preparation for war, to maintain a properly stabilized international monetary system, and to establish conditions under which healthy capital movements, long- and short-term, from countries of relatively abundant capital to capital-hungry countries can take place. Direct regulation of trade by exchange-control methods may have been a partial cause

of the failure of these conditions to prevail; it was also unquestionably an effect of the absence of these conditions, and the restoration of these conditions will have to go hand-in-hand with the abandonment of exchange control, if there is to be hope of the latter. What degrees and types of national economic planning can prevail without involving direct regulation of foreign trade by exchange-control or equivalent methods presents a more troublesome question, and one on which too little thought has been exercised if one may judge from the extreme scarcity of significant literature on the question. Many advocates of more or less authoritarian national economic planning are also advocates of as much international economic cooperation as is possible, but as a rule they would welcome the abandonment of free exchange markets and of the regulation of foreign trade by free-market processes and would have no objection to exchange controls or the quota system or an extension of state trading monopolies. On the other hand, international collaboration in the fields of monetary stabilization, of the prevention of mass unemployment, and of restoration of the international mobility of long-term capital, would no doubt both facilitate effective national regulation of national economies along lines consistent with the maintenance of free internal markets and make more likely and more desirable the abandonment or moderation of direct controls of foreign trade.

(2) Any particular policy is attractive or unattractive in the light of the alternative policies available at the time and known to be available. Are there alternative policies which will be available in the future which were not available in the 1930's or which if available then were not thought of or were not believed to be available?

In so far as exchange control was adopted or maintained in order to avoid overt devaluation or exchange-depreciation of national currencies and to preserve scarce supplies of foreign exchange for the uses regarded as nationally most urgent, it represented an emergency measure adopted because the older mechanisms of more or less automatic character for the maintenance of both exchange-stability and adequate supplies of foreign exchange for all reasonable purposes had broken down and under the circumstances prevailing seemed unlikely to be quickly re-established. There is a tendency in some quarters to accept as datum not requiring support by argument that there will be unwillingness or impossibility substantially to restore the pre-1914 mechanisms, or that it would be undesirable to do so even if it were

possible. If the other conditions which prevailed in the 1930's are to be expected to prevail also in the post-war period, namely, fear of war and preparation for war, high trade barriers, failure to prevent major depression, cessation of healthy capital movements, monetary disorganization, and so forth, a case can of course be made for this position. I do not contend that we should necessarily aim at restoring any pre-1914 institution without amendment or modification. But we should avoid the widespread tendency in the economic field nowadays to take for granted that if any proposal can be labelled as advocating a return to pre-1914 conditions it is thereby condemned as impracticable or foolish. This is not only irrational, but it is playing unconsciously into the hands of the enemy, who in the economic field have taken precisely this position, and who have in fact, if not invented, at least given wide currency to most of the practices which clash strikingly with pre-1914 principles. It would be unfashionable but not otherwise foolish to ask for consideration of the suggestion that in a peaceful and otherwise politically well-ordered post-war world re-establishment of the pre-1914 international monetary system, with some improvements and modifications which time and the growth of understanding in this field have made fairly obvious, both would be practicable and would go far towards removing any urgent need for exchange control either to protect weak currencies or to ration scarce supplies of foreign exchange.

(3) The exposition by its advocates of the merits of exchange control as an instrument of commercial policy has almost invariably been carried on from the point of view of national interest, more or less narrowly interpreted. Even if it were granted that it can be made to work advantageously for any country whatsoever, taken by itself, would it necessarily follow that it can be made to work advantageously for all of the countries practising it, considered as a unit? or for the world as a whole, including the countries not practising it?

The direct regulation of foreign trade through exchange control was practised by many countries as an emergency measure with recognition that its adoption by any country tended to make the world economic situation even worse, but in the hope that it would nevertheless make their own position better. It was essentially a *sauve qui peut* procedure, and was recognized by many of the countries following it as such, as was clearly shown in the replies to the 1935 League

of Nations questionnaire with respect to clearing agreements¹ and in the oral statements of delegates from many exchange-control countries made at the International Studies Conference held at Bergen in August, 1939.

National policies have always been fashioned primarily to serve national interests, and it must be presumed that this will continue to be the case in fields in which national autonomy prevails. But it is often clearly in the interest of a nation, as it is often in the interest of an individual member of any group, to do things in concert with others as part of a common plan which it would be against its interest to do on its own initiative. Similarly, it is often in the interest of a nation, as long as it must act singly, to do things which it would be in its interest to renounce, for itself and for the world, if it were proposed that they be simultaneously renounced by all countries, or by a large number of them. And it is often in the interest of a nation to do things on its own initiative only provided that its doing them does not lead other countries to follow suit. Granted that it is in the interest of some countries, under some circumstances, directly to regulate their foreign trade by means of exchange control, when acting singly, it may nevertheless be in the interest of these same countries, and even more so of the world at large, that there should be international agreement not to resort to the practice. If under the post-war world order nations would accept some measure of international or supra-national limitation on their practices in the field of commercial policy, it would be conceivable that international agreement might be reached for the suppression of exchange control with comparatively few dissenting votes. As a theoretical possibility, which is worth mentioning only because it helps to bring out more sharply the possibilities of divergence of supposed interest for a country acting autonomously, on the one hand, and the same country acting as a member of a group with the organization and the will to act as a group, all the countries practising exchange control might vote to suppress it.

(4) No free-exchange country except the United States made any substantial attempt in its trade negotiations with specific countries to check the growth of the use on the part of other countries of exchange-control or other instruments of direct regulation of trade. Even in the case of the United States, the action taken, whether in

¹ *Enquiry into Clearing Agreements*, Geneva, 1935.

the form of concessions offered as an inducement to refrain from the use of direct regulation of trade or of penalties applied in the event of such use, was, with the debatable exception of the treatment of Germany, ambiguous, mild and basically unimportant except as it revealed the trend of policy. What if there were important countries really anxious to preserve free-market conditions in international trade, and what if such countries were prepared to take strong measures, perhaps in concert, to make the exchange-control method of regulating foreign trade unworkable?

Exchange control, even for strictly monetary purposes, but especially when used to regulate foreign trade, almost inevitably requires, if it is to work in tolerable fashion for its practitioners, agreements with other countries which provide at the minimum for some measure of what can properly be regarded as cooperation in the conduct of the control. Countries sometimes agree to provide such cooperation because they regard it as to their advantage that the other country should practise exchange control, or because it means cooperation in return from the other country in operating exchange controls of their own, or because they fear that economic, or political, or even military penalties will be imposed upon them if they do not cooperate, or because they decide that while it would be preferable for them that the other countries should not practice exchange control, once the other countries do adopt the practise the injury to themselves will be less if they cooperate with these other countries than if they do not. The use of exchange control as an instrument of direct regulation of foreign trade would probably become very difficult, and obviously unprofitable for countries to whom foreign trade was of great importance, if a number of important countries were opposed to exchange control, in principle, or in the way in which it was operating, and decided to refrain from any action, whatever its temporary cost, which helped exchange control to work satisfactorily for its practitioners, and still more, if they applied retaliatory trade measures against exchange-control countries, and applied them also to countries which, without themselves practising exchange control in general, cooperated with the exchange-control countries in ways which involved adverse discrimination against non-exchange-control countries.

SOME SPECIFIC DISADVANTAGES OF THE USE OF EXCHANGE CONTROL
AS AN INSTRUMENT OF DIRECT REGULATION OF TRADE

We are concerned in this memorandum with exchange control only if it is carried to the extent of involving the direct regulation of the transactions of individuals involving foreign exchange, and even then only if the regulation is not restricted to capital transactions and pure exchange speculation but extends to strictly commercial transactions. Very commonly, however, once debtor countries with weak currencies embark upon direct regulation of any important types of transactions involving foreign exchange, they soon extend it to apply either to all commercial transactions or to all except certain specifically-exempted (and usually relatively minor and readily distinguishable) classes of commercial transactions. Three major reasons for such extension are apparent :

(1) If only a few categories of applicants for foreign exchange are subject to exchange-control restrictions, it proves difficult if not impossible to prevent applicants within this category from disguising their real status or changing their formal status from that of ineligible (or rationed) applicants to that of eligible or privileged applicants, and thus evading or avoiding the control.

(2) With or without evasion, the control may prove not extensive enough fully to protect the currency against exchange-depreciation if it is confined to capital and exchange-speculation transactions.

(3) Once as marked a departure from the traditional free-exchange market as exchange-rationing has been introduced and the initial prejudices against it overcome, it is a temptation too strong ordinarily to be resisted to exploit its possibilities for other purposes than mere protection of the exchange value of the national currency. In some known instances, bureaucratic delight in the control activities and ambition on the part of officials for enlarged fields of operation have also been a factor in leading to the extension of the range of exchange control once it has been introduced.

There is given below a list of objectives additional to protection of the national currency against exchange-depreciation which exchange-rationing can be made to serve, a list, be it noted, which includes only uses actually made, in well-authenticated cases, by some exchange-control country or countries. These objectives may be regarded, in whole or in part, as unsound or unworthy ones, and the writer cer-

tainly so regards some of them. Some of these objectives may be incompatible with others. Some of these objectives call for a more marked departure from free-market principles than others. Import quotas or state monopolization of foreign trade may be regarded as more effective instruments than exchange control for serving some of these objectives, or they may be used in conjunction with exchange control for these purposes. Exchange control may be and ordinarily is used as a supplement to rather than as a substitute for ordinary tariff duties. But from the point of view of flexibility and of the possibility of fine adjustment to the special purpose and the particular circumstances of the moment, exchange control, it must be conceded, has with respect to most of these objectives distinct and obvious advantages over the traditional tariff devices for accomplishing the same purposes. The list of possible objectives or uses of exchange control follows:

(1) To provide additional protection against foreign competition to domestic industry.

(2) To be used as a trade-bargaining instrument to induce foreign countries to modify their tariff, quota, or other restrictions on imports from the exchange-control country in question or otherwise to make their trade policies conform to its wishes.

(3) To force a decline in the market quotations of national securities held abroad by preventing nationals from using their foreign-exchange assets to buy them or to meet interest or amortization obligations on them, and thus to make possible their repatriation at bargain prices.

(4) If a debtor country, to divert the use by nationals of their holdings of foreign exchange from meeting debt service on external indebtedness to the purchase of commodities.

(5) If a creditor country, to influence, in the direction wished, the apportionment by a debtor country of its holdings of the creditor country's currency as between use in the purchase of the creditor country's commodities and use in service of or liquidation of outstanding debt.

(6) With the aid of over-valuation of the national currency in clearing agreements, to obtain a flow of imports in excess of the flow of exports, and thus to obtain quasi-forced loans from other countries; at a later stage, to obtain preferential treatment, for its exports, from the countries with which these deficits in clearing balances have

been incurred, because of the anxiety of the governments of these countries to obtain liquidation of credits which are of problematic security, are non-interest-bearing, and are burdensome to carry for the national treasuries.

(7) By the establishment of a wide margin between the prices in national currency at which holders of foreign exchange must surrender it to the control and the prices at which the control releases it, or by other equivalent devices possible under exchange control, to provide a source of revenue for the national Treasury, to be used perhaps in subsidizing exports.

(8) To provide the national Treasury with foreign exchange for government use at lower rates than those available to private buyers.

(9) To make it possible to maintain an artificial price structure internally, without disturbance from the impact of price conditions prevailing in outside markets.

(10) By threat of unfavourable treatment or the promise of specially favourable treatment under the exchange control to bring pressure to bear on other countries with respect to the general orientation of their political or economic policies.

From the narrowly national point of view, the direct regulation of foreign trade by means of exchange control thus appears to have many advantages as compared either to leaving foreign trade free to respond to market conditions or regulating it indirectly through tariff measures. There are important disadvantages, however, in direct regulation of trade by means of exchange control, even when considered only from a narrowly national point of view.

The costs and inconveniences to traders of conforming to the formalities of exchange-control procedures, as also the administrative cost to the governments as reflected in tax burdens, must act as a restraint on foreign trade. The maintenance of the currency at an overvalued exchange level which exchange control makes possible operates to reduce exports, and the exchange-rationing which the overvaluation of the currency makes necessary operates to prevent the imports from exceeding the exports. It is impossible, however, to say whether or not these restrictive factors are fully offset by the export subsidies of the exchange-control countries, the use by those countries of multiple-valued currencies, their special clearing agreements with other exchange-control countries, their promotion of outright barter transactions under government auspices, and the preferential treat-

ment sometimes given to imports from the exchange-control countries by strong-currency creditor countries in order to obtain payment on outstanding indebtedness or alleviation of the exchange-controls as applied to their export.¹

What can be said with assurance, however, is that the *quality* of foreign trade, the extent of its contribution to the well-being of the participating countries, tends to be impaired by the existence of exchange control and its associated practices.

Exchange control changes the direction of foreign trade from what it would be in a world as nearly similar as possible except for the absence of exchange control, and clearly changes it for the worse. The individual trader in the absence of exchange control makes his decisions as to what export or import transactions to enter into on the basis of price-comparisons as between different markets and sources of supply. Under exchange control he must in addition take into account, if an exporter, which potential foreign buyers will be permitted by their governments to convert their domestic currency into the seller's currency for payment purposes, and if an importer, to which foreign country he will be permitted by his own government to make payment in a currency acceptable to the seller and the seller's government. The net effect of these extra restrictions on the trader's choice, after all allowance for the ameliorations in the exchange-control régime which may have been introduced, is to enforce deviations in the course of foreign trade from the direction which unrestricted traders' decisions would give it. These deviations are, from the point of view of the world economy, at best fortuitous, and are therefore,

¹ A clause in the Argentine-Brazil Trade Agreement of 1941, apparently unique in the history of trade agreements, provides that annual trade balances in the commerce between the two countries exceeding a certain amount may only be collected by means of an increase in purchases by the creditor country. If such a clause were widely adopted and could be carried out both in the letter and in the spirit, whatever tendency trade-bargaining between two countries on a bilateral-balancing basis has to restrict the total volume of foreign trade *as between the two countries* might be largely removed, since there would be avoidance of the two main trade-restrictive methods by which under existing practice bilateral balancing is achieved, namely, restriction of imports by the "debtor" or import-surplus country, and restriction of exports by the "creditor" or export-surplus country. A party to an agreement containing a clause of this type which finds itself with an export surplus with respect to the other party would presumably be obligated by import-subsidy, or direct government purchase, or persuasion of traders, to bring about an increase of imports from the other party to the agreement. But the methods it used might well be such as to increase its imports from the other country at the expense of imports from third countries rather than to increase its total imports.

assuming that dealers' decisions are on the whole rational in themselves and reflect rational decisions of producers and consumers, economically wasteful.

In so far as the practice of exchange control results in a definite pattern of deviation of the course of trade from that which it would follow in the absence of exchange control, the most obvious aspect of the pattern consists in a relative contraction in the trade between exchange-control and non-exchange-control countries as compared both to the trade of exchange-control countries among themselves and to the trade of non-exchange-control countries among themselves. This segmentation of trading countries into two groups, with reduced trade between the groups, is, however, but one phase of a wider pattern of the same character.

Exchange control is designed to eliminate unfavourable over-all balances of immediate payments in foreign currencies, and it pursues this objective primarily by restricting the development of unfavourable balances of immediate payments in foreign currencies with particular countries, country by country. There results in consequence a strong tendency for the balances of immediate payments of exchange-control countries to become even both with other particular exchange-control countries and with particular non-exchange-control countries, and this tendency is reinforced by the bilateral arrangements which exchange-control countries enter into with each other and which always have in view the elimination or reduction of net balances of payments between the negotiating countries. This involves for the course of trade a strong tendency to bilateralism, that is, to even balances of trade as between pairs of countries one or both of which are exchange-control countries, and thus to suppression of multilateral trade. But there is no reason to suppose that, if trade were free to take its own course, multilateral trade would, unit for unit, make any less contribution to economic welfare than would bilateral trade. The bias against multilateral trade inherent in exchange control is a major count in the case against this method of trade regulation.

Attempts to mitigate this objectionable feature through superimposing on the national exchange controls an organized system of multilateral clearings have been strongly advocated by some writers, who see in the method of national exchange controls operating through multilateral clearings the ideal trading system and the ideal international currency system. At least one attempt was made to set up

multilateral clearing arrangements between a limited group of countries—by Greece, in 1934, in agreements with Yugoslavia, Rumania, and Turkey. Under these arrangements, each country entering into agreement with Greece agreed to accept, in payment of a specified percentage of its net creditor claims on Greece, the claims of Greece on third countries. As Greece, however, had substantial net claims only on Germany and all the other three countries were also net creditors of Germany, the arrangement did not really promote all-around clearing and soon broke down. Germany is now operating a multilateral clearings system for herself and some of her satellite and conquered countries, centered in Berlin, operating on the basis of the Reichsmark, and no doubt conducted primarily in the economic and military interest of Germany.

Even if an imposed equalization for each country between the global value of its imports and the global value of its exports were acceptable as a desirable objective, a system which pursued this objective, as exchange control does in effect, by seeking for each country an imposed equalization of its trade balances with each other country would obviously involve heavy economic cost. There is no reason why, in the nature of the geographical distribution of productive resources and of wants, each country should wish to buy from each other country goods and services to just the value which the other country wished to buy from it. Equalization of trade balances by pairs of countries is an intermediate phenomenon between bilateral individual barter on the one hand and a world-wide system of buying in the cheapest and selling in the dearest market, on the other hand.

The disadvantage of barter, as compared to a price-system market, is that, by requiring the "double coincidence" that wants of one party should match the surplus supplies of the other and *vice versa* for trade bargains to be made, it drastically reduces for both parties the range of choice as between attractive buying and selling opportunities. This disadvantage applies equally in principle to enforced equalization of trade balances for pairs of countries. Under bilateralism, imports are often not permitted to be made from the cheapest sources; and there is an artificial restriction also of the range of commodities which can be imported, because some commodities are available only from countries which are unwilling to make offsetting purchases.

It cannot be demonstrated by abstract analysis whether the exchange-control system tends to reduce or to increase the total volume

of foreign trade, and the record of actual experience also fails to provide a clear answer to this question. The major obstacle to finding an answer to this question whether by abstract analysis or from a study of actual experience is that it can never be ascertained with certainty what the alternative to exchange control would have been, whether higher ordinary tariffs, or exchanges left free to find their level or to fluctuate, or a quota system on top of the existing tariffs, or what. Another obstacle lies in the fact that "exchange control" is rarely a simple device, and as a rule includes some combination of exchange rationing, multiple exchange-values as between any two currencies, export subsidies to offset the restrictive effect of overvaluation of currency on exports, clearing agreements, outright barter transactions, government operations on its own account outside the control, and other devices.

If the exchange-control system as it operates in practice involved strict equalization of trade balances between pairs of countries, and involved nothing else, it would be possible to affirm that exchange control operates to reduce the total volume of foreign trade. Imposition of the requirement of bilateralism reduces for buyers in each country the range of choice as to source and kind of import and reduces for producers in each country the range of choice as to destination of export. On the other hand, bilateralism leaves unaltered the range of choice as to domestic production for domestic consumption (except as the restrictions on import operate to reduce the available range of instruments and materials of production for domestic consumption). With the attractiveness of import and of export thus both diminished, while domestic wants and domestic means for satisfying them directly through domestic production remained undiminished (subject to the qualification noted above), there should be a decrease in the relative extent to which wants are satisfied through import as compared to domestic production, i.e., there should be a decrease in foreign trade. But there has been under exchange control at its worst¹ only an approximation to complete bilateralism. Moreover there were associated with the bilateral clearing arrangements under the exchange-control system: permitted or illegal transactions outside the

¹ How strong has been the tendency to appraise the institution of exchange control in terms of its own logic rather than by more fundamental principles of world economic welfare is revealed, for instance, by the frequent instances in which, in the literature bearing on exchange control, its failure to achieve complete bilateralism is regarded as a mark of imperfection rather than as a mitigation of its evil.

clearings; export subsidies; open or concealed partial devaluations of over-valued currencies; and official promotion by creditor countries of imports at what would under normal circumstances be regarded as unattractive prices in order to absorb blocked clearing balances or to make possible liquidation of outstanding debt. These factors all operated to make the volume of foreign trade exceed what it would be under strict bilateralism, and their association with exchange control provides the justification for the proposition made earlier that it cannot be demonstrated on the basis of abstract analysis that the exchange-control system necessarily operates to reduce the aggregate volume of foreign trade.

It is an additional disadvantage of exchange control that it lends itself readily to the regulation of foreign trade in accordance with the principles of discriminating monopoly. It is, as we have seen, possible for a country, assuming skilful management, to profit by conducting its foreign trade on monopolistic principles; but the gain to it will as a rule be smaller than the loss to the countries it trades with. If these other countries follow suit, and also adopt monopolistic practices, there may still be gain to each one as compared to its following non-monopolistic principles *alone*, but there will be loss all round as compared to the situation if none of the countries operated on monopolistic principles; moreover, there will be no logical stopping point in the process of imposing restrictions on trade with the aim of improving the national terms of trade. Trade bargaining will tend to be conducted primarily by governments instead of by the individual traders themselves, in an atmosphere of sparring for advantage, of threat and counter-threat, and of the multiplication by each country of impediments to trade which it does not want for their own sake, but which it feels it must introduce as a counterweight to the restrictions imposed for bargaining purposes by other countries. Simultaneous retreat by a number of countries from this process of destroying foreign trade in the hope of deriving greater profit from it would be mutually advantageous, and, judging by experience under exchange control in recent years, would be widely recognized as such. But single-handed retreat would seem dangerous for the retreating country—and might be so in fact—and joint retreat might be difficult to organize.

That the attempt to conduct foreign trade on monopolistic principles is a dangerous game when there cannot be assurance that you

will be permitted to play it alone is not unknown to government officials responsible for trade policy—or does not long remain unknown to them once they have tried it. Unfortunately, it is a game which a single player can more easily start than finish, and the temptation to make use of the delicate instruments for playing it which exchange control provides—flexible restrictions on imports, with discrimination between countries, persons, commodities, with respect to exchange rates, subsidies, exchange allotments—seems to be irresistible in practice. In many cases, no doubt, officials have slid into the practice of duopolistic bargaining without being fully aware of the nature of the process, or of its full economic implications, and once in could see no easy way of retreat.

That the direct regulation of foreign trade through exchange control tends inevitably to lead to the direct regulation of internal trade, and *vice versa*, would nowadays be regarded by many persons as an argument in favour of exchange control rather than against it, and this is not the appropriate place to develop the case against further expansion of direct regulation of trade in general, including internal trade. It is appropriate, however, to point out that the growth of exchange control has been both a product of and contributory factor to that drastic contraction of the field of free enterprise which has been the most marked economic trend of the past distressful decade. It may be appropriate also to suggest that it was not a mere coincidence that exchange control has been carried furthest in the most authoritarian countries.

As an incident to the extension of government regulation of the course of trade involved in comprehensive exchange control, there is superimposed on the bargaining between individual private traders in different countries a pattern of continuous and detailed collective trade bargaining between their governments, or, as an intermediate case, a pattern of collective bargaining under official sanction and supervision between national cartels of exporters or importers organized for the purpose.¹ Given the development of sanctioned or unsanctioned private monopoly within national economies, there may be little to choose between collective bargaining in foreign trade under wholly private auspices and collective bargaining between governments; indeed, if national economies are operated largely on a pri-

¹ International bargaining and agreements between *producers'* cartels for the limitation of competition are a different matter, not dealt with here.

vate-monopoly basis, governmental supervision and regulation of the transactions between the domestic monopolists and the foreign monopolists may be urgently required to protect the interests of sections of the population not represented in the monopolies but affected by their activities. It is obvious from the record, however, that when governments have shown interest in the external operations of their private monopolistic organizations they have done so much more often with the purpose and result of strengthening the monopoly position, internally as well as externally, of these organizations than to protect other sections of the community from exploitation by them.

Governments have not only often promoted the establishment of monopolistic export or import organizations at home to facilitate the process of collective trade bargaining with other countries, but have sometimes, for the same reason, pressed other governments to establish them in their own countries. In any case, exchange-control procedures provide added incentives for and encouragements to monopolistic organization even in the absence of official encouragement. The complexities of exchange-control regulations are often too great for small concerns to cope with, and the individual small trader is likely to be given little weight in the struggle for exchange priorities and allotments, to lack the financial resources required to carry blocked balances and to wield too little political influence to be able to obtain reasonable consideration of his interests in the bargains made with other countries.

Many persons nowadays, however, regard the organization of industry and commerce on monopolistic lines as either desirable *per se* or as an inevitable trend of the times which must be accepted, whether desirable or not, and would not consider it an important defect of the exchange-control system that it promoted the growth of monopoly. Since it is not possible here to enter into a discussion of the comparative merits and the comparative practicability under modern conditions of the monopolistic and the competitive modes of economic organization, the point that exchange control promotes monopoly will not be pressed here as an argument against exchange control.

The fact, however, that under exchange control bargaining between governments is superimposed on or substituted for the bargaining between private traders in different countries has great importance. When trade relations become a systematic and direct

concern of diplomacy, they become also political matters more directly and intensively than when they are left primarily in private hands with diplomacy invoked on their behalf only to exert its good offices in particular instances of impact with foreign legislation or administration or when, at long intervals, a tariff treaty is to be negotiated or renewed. The constant negotiation on trade matters which exchange control makes necessary, the importance of the issues involved, the unsuitability for the processes of exchange control of commercial treaties binding for long periods, the absence of traditional or other generally-accepted principles providing a framework for the specific details of agreements, the inherent tendency of exchange control to involve discriminatory treatment between countries or at least the absence of simple and generally-acceptable criteria of equality of treatment applicable to exchange control, all of these provide a fertile field for international friction. Admirers of exchange control have cited as one of its advantages that it almost necessarily involves international negotiation, which they identify with international collaboration. It is true that international *agreements* always in a sense involve international collaboration. But "negotiation" may be only a euphemism for quarreling, full economic collaboration does not necessarily involve official negotiation or agreements on matters of detail, and the agreements which are associated with ordinary processes of exchange control sometimes have the character rather of temporary breathing-spells in a continuing process of bickering and of mutual economic blockade than of genuine international economic collaboration. It is perhaps the major count against exchange control, in this connection, that since international negotiations in connection with its operation have no general mutually-acceptable and readily-understood principles to guide them, they therefore invariably degenerate into *ad hoc* agreements on a wide range of questions of detail, revealing no broad pattern consistent with genuine international economic collaboration, and providing no satisfactory basis for, if not specifically foreclosing, generalization of the concessions made in the agreements to third countries.

Exchange control, therefore, does not provide a satisfactory basis for the organization of international economic relations on genuinely collaborative principles. The only defence of it that can be made—and it is a strong defence—is that under the circumstances prevailing when it attained its growth, there appeared to be for some countries

no other and better alternative. It may well be that in a world in which the threat of war is always overhanging, in which currencies are disorganized and international credit machinery has collapsed, in which creditor countries, while insisting on payment of their claims, won't accept payment in goods, exchange control with its severities modified by clearing and payment and compensation agreements is the only barrier to a complete breakdown of international economic relations. In any case, no one has shown that in the 1930's there was available any better alternative except through multilateral agreement which would treat as integral parts of one giant problem the need, in the political field, for world-pacification, and in the economic field, for the re-establishment of sound international monetary and credit institutions, the all-round reduction of trade barriers, and the restoration of good employment conditions. With the rise of Hitler to power and the failure of the London Economic Conference in 1933, this alternative became for the time being an impracticable one. There is no excuse, however, for projecting defeatism with respect to the past, where it may be justifiable, into the future, where it never is. It would be yielding without a struggle to this attitude, and providing it with almost its only rational support, if the assumption that it will be possible in the post-war world to do away with or at least keep within narrow limits some of the obvious evils of the past were commonly rejected on the ground of its lack of "realism." The argument which follows is intended, however, to show that it is not realistic to expect that the general abandonment of exchange control or even any important moderation of its most undesirable aspects can be procured by any country, acting singly, no matter how important it is, or by any small group of countries unless that group includes several of the major trading countries.

THE RESPONSE OF FREE-EXCHANGE COUNTRIES TO THE OPERATION OF EXCHANGE CONTROL IN OTHER COUNTRIES

The free-exchange countries have in general looked with disfavour upon extension of exchange control to new countries or widening of its scope in countries already practicing it. They have feared that in operation the exchange controls of other countries would have unfavourable immediate impacts upon their own foreign trade. In some cases they were concerned lest the pressure on their own economies of the exchange controls of other countries should force them to adopt

similar measures themselves. But there have been marked variations in the reactions of free-exchange countries to the exchange-control measures of other countries.

The operation of exchange control in other countries impinges unfavourably upon the interests of individual traders (or firms) in free-exchange countries in a number of ways.

(a) Holders in the free-exchange countries of claims against debtors in the exchange-control countries, whether these claims are financial in character (debt-service) or arise out of past commercial transactions, find that they cannot collect on these claims or can collect only in the form of blocked balances which are not usable or transferable or are usable or transferable only subject to serious and uncertain delay or to such severe limitations as to make their value in terms of their own currencies very much lower than their value at the official exchange rates.

(b) High export prices in the exchange-control countries when calculated at the official rates of exchange tend to make their export commodities unsaleable in the free-exchange countries. Even therefore when the proceeds of exports to free-exchange countries are made available for payment for imports from such countries, the limited amounts of such proceeds make new exports from free-exchange countries to the exchange-control countries subject to serious uncertainty of time and degree of payment.

(c) The exporters of the free-exchange countries find themselves competing in foreign markets with the subsidized exports of exchange-control countries, and domestic industries in the free-exchange countries find themselves competing in their own home markets with subsidized imports from exchange-control countries or with imports offered at specially low prices because the exporters in the exchange-control countries, or their governments, are anxious to obtain free currencies, or because the foreign producers of the commodities in question find their normal export markets closed to them or rendered unattractive by the operation in those markets of exchange control.

(d) There is also the potential injury to the economy of the free-exchange country resulting from the fact that exchange control lends itself readily to the regulation of foreign trade, both on the selling and on the buying side, on monopolistic principles even if industry within the country operates on competitive principles. The terms on which a free-exchange country exchanges its commodities for the

commodities of an exchange-control country will therefore tend to be less favourable to the former than if both countries operated on a free-exchange basis. It is in the nature of a free-exchange economy, however, that this burden is not readily perceivable, and that even where it falls heavily on individual traders or producers or consumers, the factor responsible for the burden is not readily identified.

It may be conceivable that a country should proceed along its accustomed lines of trade policy without reference to the adoption and operation of exchange controls by other countries, i.e., that it should make no attempt to modify its trade policy so as to minimize the unfavourable impacts on its economy of the exchange controls of other countries.¹ It is highly unlikely, however, that any country with important economic contacts with the outside world would find this a satisfactory procedure unless the foreign demand for its important export products were highly inelastic, and in any case very few, if any, countries seem to have followed it.

Almost universally, therefore, if not universally, countries have attempted to deal with the unfavourable impacts on their foreign trade of the exchange controls of other countries by modifying their own trade policies. The introduction of exchange control (and other forms of direct regulation of trade) has contributed to almost complete elimination of "autonomous" trade policies, or trade policies pursued without regard to the policies of other countries and implemented solely through national legislation—usually ordinary tariff legislation—without recourse to trade bargaining with foreign governments. Generally characteristic of the methods followed is that they have involved an increase in administrative freedom and flexibility in dealing with trade policy and in resort to other devices than mere changes in ordinary import duties. Beyond these common phases there has been resort to so great a variety of methods as between countries, and even within the same country, that generalization is impossible.

The method which countries have most often adopted to deal with the impact on their foreign trade of the exchange controls of other countries has been to adopt some exchange-control measures them-

¹ The possibility that a country should regard the exchange controls or other direct controls of some other countries as providing it with an opportunity, through appropriate methods, to *better* its trade position as compared to what it would be in the absence of such controls in these other countries is discussed later.

selves, although sometimes restricted to transactions with exchange-control countries with exchange transactions otherwise left free from direct controls. In most of the countries adopting it, exchange control was at first regarded as a necessary evil, to be overcome as soon as the pressure on the exchanges was sufficiently alleviated. This provides a theoretical basis for classifying exchange-control countries according to whether the controls are "aggressive" or "defensive," "comprehensive" or "limited," maintained enthusiastically or reluctantly. In practice, however, it would be difficult to apply such classifications, since they depend so much on intent or motive, which is hard to ascertain with certainty in particular cases, and will not necessarily be invariant through time. There is no doubt, however, that some countries have acquired a belief in the inherent virtues of exchange control and wish it to continue and to spread, while other countries which practice it regard it, after some years of practice, as at best a necessary evil and would cheerfully abandon or at least relax their controls if they could be assured that most other exchange-control countries would do so or that there would not be severe pressure on the exchange value of their currencies if the controls were removed. During the years 1935-6, when business conditions and world trade were generally on the up-grade, there was in fact a mild movement in the direction of the relaxation of exchange controls, which extended, however, only to a limited number of countries. Even in those years the general tendency in some countries, most notably Germany, Japan and some of the Latin-American countries, was for a progressive tightening of the controls.

A substantial number of countries which in general have desired to avoid direct regulation of trade as far as possible have nevertheless applied special controls to transactions with exchange-control countries¹ while leaving transactions with free-exchange countries free from control. Some writers have seen in this procedure not only a desirable means of dealing on a temporary basis with an emergency situation but also a happy long-run solution of the problem of the operation of a world economy which is permanently partly on an exchange-control and partly on a free-exchange basis. As they see it,

¹ I regard a country which enters into clearing or payment agreements with an avowed exchange-control country, but otherwise does not directly regulate exchange transactions, as adopting a limited "exchange control," but I recognize that this is not in accord with common terminological usage.

each country is free to adopt comprehensive exchange control or not, as it pleases; countries which in general prefer to keep their exchange markets free from direct control can, if they wish, adopt exchange control but limit it to transactions with exchange-control countries.

As a short-run method of adjustment to an emergency situation, there is from the national point of view much to be said in support of this procedure as compared to the available alternatives. If it is so conducted as to reduce the range of freedom of the exchange-control countries to use their exchange controls for monopolistic or political pressure purposes or to avoid meeting their external liabilities arising out of past financial or commercial transactions, and if it thus makes them less enthusiastic about the advantages of exchange control and less likely, therefore, to adhere to it permanently, it may even make a contribution to the eventual return generally to free-exchange, free-market methods. Nothing which is said here is intended to be critical of whatever measures free-exchange countries may adopt to protect themselves against injury from the operation of other countries' exchange controls, provided these measures have their adverse impact solely on the exchange-control countries and not on themselves or on innocent third countries. But for the reasons given below, the adoption of partial exchange control on their own part is not an acceptable *long-run* solution for countries which are anxious both that they themselves shall not slide into comprehensive exchange control and that they shall not themselves add to the extent to which world trade in general is lastingly subject to it.

First, the adoption by any country of exchange control, even if adopted as a protection of that country's trade against exploitation by the exchange controls of other countries, operates to reinforce the other existing exchange controls and to make their operation smoother even if on basic economic accounting less profitable.

Second, there is usually a strong tendency for a limited exchange control, once adopted and strongly entrenched, to become more comprehensive in its scope. Once the ice has been broken, and departure has been made from the principle of the free-exchange market, it is easy psychologically to move on further in the same direction. The establishment of the necessary bureaucratic machinery and mastery of the technique of exchange control, and the bureaucrats' pleasure in the exercise of the control mechanism, also facilitate its extension to new fields. More important, the narrower the scope of

a control the more difficult it is to prevent evasion thereof. It appears to be the general experience that a limited control involving allotment or rationing of foreign exchange will be largely evaded if all important categories of exchange transactions are not required at least to be licensed and to be reported to the control authorities or to be channeled through an agency having a monopoly of sales of foreign exchange.

Third, it is to be remembered also that *A* may be unfavorably affected by the operation of *B*'s exchange control not only through its effect on the trade relations of *B* with *A*, but also through its indirect effect on the trade relations of a third country, *C*, with *A*. *B* may use its exchange control to force *A*'s products out of *C*'s markets, or to make *C* use its foreign exchange receipts to buy commodities from *B* instead of repaying debt to *A*, or to repay debts to *B* instead of buying commodities from *A*. If *A* decides to deal with *B*'s exchange control by itself adopting exchange control in its transactions with *B*, it will be logical for it also to adopt exchange control in its transactions with *C*, as an additional protection against injury from *B*'s exchange control.

Fourth, if the free-exchange countries adopt measures for dealing with the exchange-control countries which result, whatever their intent, in promoting imports from the exchange-control countries at the expense of imports from other free-exchange countries, the consequence is, of course, even though unintended, to push the remaining free-exchange countries into bilateralistic practices in self-defence.

The Swiss experience here offers a striking illustration. In 1931, Switzerland introduced, with respect to certain important import-commodities, a clearing system which was intended, according to the text of the law, "in a general way to expand, guarantee, restrict or prohibit imports from particular countries depending upon their treatment of Swiss exports." The Government explained that this measure would enable it to favour those countries which permit import of and payment for Swiss commodities, and to limit or prevent altogether imports from countries which place insurmountable obstacles in the way of Swiss exports. In actual practice it worked in the opposite direction. Since the system imposed no restrictions on exports to the exchange-control countries while it gave Swiss exporters assurance of eventual payment, it resulted in increased exports to the exchange-control countries. In order to check the accumulation

by Switzerland of credit claims on the exchange-control countries, it became necessary for the import-control agencies to favour imports from the exchange-control countries as against imports from the free-exchange countries. The proportions of the total imports into Switzerland of the specific commodities affected, coming from free-exchange countries, exchange-control countries which imposed clearing requirements on imports from Switzerland, and exchange-control countries which did not impose clearing requirements on imports from Switzerland, were, respectively, 37.6%, 52.7%, and 9.7% in 1935, as compared to 86.5%, 3.0%, and 10.5% in 1932.¹

Where countries which maintained and wished to continue to maintain generally free-exchange markets have nevertheless applied exchange control in a limited way to transactions with other countries which practiced exchange control, they have frequently followed the procedure of insisting upon clearing arrangements with the exchange-control countries. Clearing arrangements have become a common appendage to exchange controls. But it has generally been the strong-currency countries, including free-exchange countries, which asked for their establishment in the first instance, because of the desire of their exporters to get payments in other than blocked balances, or to enforce the allotment of a portion of the supplies of the strong currencies accruing to the exchange-control countries to debt-service payments or to liquidation of outstanding commercial indebtedness, instead of to the financing of new commodity imports. But weak-currency countries have also imposed clearing arrangements upon countries with stronger currencies where the trade-balances between the two were unfavourable to the weak-country currencies, usually with the objective of forcing the strong-currency countries to accept larger volumes of import.

How clearing arrangements entered into by otherwise free-exchange countries with exchange-control countries would operate for the former would depend of course on the strength of their bargaining position, and the skill used in bargaining, and thus on the specific kind of arrangements they could make, vis-à-vis the exchange-control countries. The general tendency has been, however, for import-surplus countries with clearing agreements with weak-currency countries

¹ Cf. André Geiser, *Die Kompensation als Mittel der Aussenhandelspolitik unter besonderer Berücksichtigung der Schweiz*, Solothurn, 1939, pp. 62, 101-102, 108-109.

to find that they result, unless additional measures are taken, in the indefinite accumulation of debit balances of the weak-currency to the strong-currency countries, which balances must be carried either by the strong-currency governments on behalf of their exporters or by the exporters themselves. This tendency results from the fact that dealers in the weak- or overvalued-currency countries find the products of the strong-currency country to be attractively priced and therefore import heavily, while dealers in the strong-currency countries find that the weak-currency commodities, if purchased through the clearings, are priced too high, and therefore seek other sources for the supplies they want or find means of purchasing from the weak-currency countries outside the clearing arrangements and at exchange rates more favourable to themselves than those available in clearings transactions. In some cases, the governments of the weak-currency countries have secretly tolerated or even promoted exports to strong-currency countries outside clearing-arrangements because of their desire for unencumbered foreign exchange. The methods whereby the free-exchange countries can check the indefinite accumulation of credit-balances in blocked currency in the exchange-control countries are also unattractive to the free-exchange countries, and when adopted are regarded as necessary evils. They consist either of restrictions on exports to the exchange-control countries where credit balances have been accumulating or of the fostering, by preferential treatment, import subsidies, or pressure on importers, of imports from these countries.

The methods used to cope with the exchange controls (and other methods of direct regulation of foreign trade) of other countries by the United Kingdom and the United States, the two leading countries with strong currencies and free-exchange markets, were in rather sharp contrast, mainly explicable, no doubt, by the differences in their bargaining position vis-à-vis other countries. (See pages 49-50 *infra*.)

The United Kingdom would, no doubt, like the United States, have been glad if in the 1930's there could have been brought about a general abandonment of the new direct controls of foreign trade. In 1936 she joined with the United States and France in subscribing to the Tripartite Monetary Agreement, which was made to include, on the initiative of the United States, a declaration that the signatory countries "attach the greatest importance to action being taken without delay to relax progressively the present system of quotas and

exchange controls with a view to their abolition." The records of the League of Nations show that she participated anxiously and wholeheartedly in attempts to find a multilateral procedure for the abolition of these controls. In accord with France, in May, 1937, she charged M. van Zeeland with the mission of exploring the possibilities of obtaining a general reduction of quotas and of other obstacles to international trade. In placing her faith in a multilateral solution, she was undoubtedly on the right track. In reacting vigorously, in the absence of such a solution, against countries, like Germany, which were using the new methods for clearly aggressive purposes, she was serving well not only her own interests but also the interests of third countries. But in her trade negotiations with other specific countries, including Denmark, Norway, and the Baltic countries, whose trade policies could not be regarded on any grounds as aggressive, the United Kingdom has systematically and openly endeavored to obtain what advantages she could for her export trade from the introduction elsewhere of direct controls and bilateralistic trade methods. Instead of endeavouring in specific cases to check the expansion of these methods, she has pressed for their extension where their introduction would facilitate the establishment of an improved position for British exports. The normally great excess of British commodity imports over exports with respect to most countries and to her foreign trade as a whole, the fact that her large sales to other countries of shipping, insurance, and banking services were made largely to countries committed to free exchanges and to non-bilateral-trade methods, and the availability in the United States of an unlimited market, at an artificially high price, for the product of the gold mines from which, through British ownership and through favourable balances of payments with gold-producing regions, she derived a substantial amount of dollar exchange, placed her in a strong bargaining position with respect to most countries if she was prepared to use—or to threaten to use—bilateral trading methods.

From 1933 on, the United Kingdom embarked frankly on trade bargaining on bilateral lines. In a provisional trade agreement with Estonia signed in July, 1933, she obtained the inclusion of the following expression of the bilateral principle:

"Both Governments undertake to keep in view the balance of trade between the United Kingdom and Estonia, and the Estonian

Government recognizes that it is in the interest of both countries that the present disparity in that balance should be readjusted as far as possible by the increase of the sale in Estonia of goods the produce or manufacture of the United Kingdom.”

In later British agreements the principle was frequently restated, and provisions conforming to it were obtained. In these agreements other countries agreed to use their existing direct controls, or new direct controls to be established for the purpose, to increase their takings of British exports, or to allot to the liquidation of outstanding commercial indebtedness to British exporters or to service on sterling financial indebtedness stated minimum proportions of the sterling proceeds from commodity exports to the United Kingdom—in some cases, in order that more sterling should be available for debt service they agreed to *restrict* their imports of British commodities through direct controls. Although the United Kingdom adhered strictly to the unconditional most-favoured-nation principle as far as ordinary import duties and imports from outside the British Empire were concerned, and although she insisted upon unconditional most-favoured-nation treatment, as a minimum, of her exports to other countries, she pressed for preferential treatment for her exports by countries where her excess of imports over exports and the availability of alternative sources of supply for the imports made her bargaining position strong.

The particular types of concessions sought by the United Kingdom varied from country to country. The following partial list of types of concessions obtained by the United Kingdom in trade agreements entered into in the 1930's (including unpublished and possibly unwritten agreements) brings out sufficiently her readiness to enter into arrangements of a strictly bilateral character, i.e., arrangements in which the tariff, or quota, or import license, or exchange-allotment treatment of British exports was made expressly to depend on the volume of British imports from the respective countries: (1) mutual purchase agreements, i.e., “guaranteed quotas,” under government sponsorship—and presumably to be carried out under government supervision—between export and import cartels of the United Kingdom and other countries; (2) agreements by the exchange controls of other countries to use minimum stated percentages of the sterling proceeds from exports to the United Kingdom in remittances to the

United Kingdom in payment for imports from or outstanding indebtedness to the United Kingdom; (3) with respect to coal, allotments to the United Kingdom of stated minimum percentages of their total imports of coal, which percentages were substantially in excess of those previously prevailing¹; (4) pledges to give preferential treatment to British firms or commodities in government purchases; (5) allotments of import licenses and exchange permits for purchases of British goods in amounts proportioned to the amounts of total exports to the United Kingdom.

The United States, on the other hand, has with only a few minor exceptions refrained in her trade negotiations with other countries (but not including Cuba) from making any demands which would involve or tend to involve any preferential treatment to American exports in the application of quantitative controls or which would require for their execution the maintenance or extension—and still less the new introduction—of direct or quantitative controls of foreign trade. The contrast in the bargaining position of the two countries has no doubt been the determining factor in leading to the contrast in the bargaining methods of the United Kingdom and the United States. The United States normally has a pronounced excess of commodity exports over commodity imports (as contrasted to the normal excess of imports of the United Kingdom), both for most individual countries and for her foreign trade as a whole. The high American tariff has operated to restrict American imports very largely to raw materials and foodstuffs with respect to which her import demand is highly inelastic and her bargaining position therefore weak. In all the major instances of countries with favourable balances of trade with the United States, the American imports consist to a large extent of rubber, tin, sugar, or coffee. The United States, therefore, is in a particularly disadvantageous position for trade bargaining on the bilateral principle, particularly if, as has so far been the case, other countries could safely take for granted that the United States would not inject into the bargaining process the question of the terms on which she would purchase foreign gold and silver and would permit the expenditure of dollars on purchases of foreign insurance, banking, shipping and tourist services.

In 1933 and 1934 there was serious debate within the Administra-

¹ In some cases, execution of these allotments made necessary the establishment by the importing countries of cartels with a monopoly of coal import.

tion as to the relative desirability of the adoption by the United States of bilateral methods, and in a few instances, in connection with the use of the quota system in connection with liquor imports after the repeal of prohibition, trade agreements were entered into which were basically inconsistent with the spirit of multilateralism in trade. But if there was ever any temptation on the part of the United States to apply bilateral principles in her trade relations as a whole with the few countries which would have been vulnerable to such methods, the temptation was as a rule successfully resisted in order not to compromise the general American position of opposition on principle to the regulation of trade through exchange control, and especially to its regulation in a manner seriously inconsistent with the principle of equality of treatment of foreign countries.

The American government was faced, therefore, with the problem of how to secure for American exports, in a world rapidly moving toward exchange control and bilateral trading practices, adequate protection against unfavorable discrimination by the exchange controls of other countries without recourse to methods involving resort by the United States itself either to exchange control or to other practices which would necessarily involve either the United States or other countries in the violation of the principle of equality of treatment.

The procedure followed by the United States can be most effectively illustrated by a digest of the various types of provisions relating to exchange control which made their appearance in trade agreements negotiated by the United States since 1934. It may safely be presumed that all of these provisions were inserted on the initiative of the United States. The variations in the types of provisions are to be explained partly in terms of the evolution of American ideas as to what constituted adequately protective formulae, partly in terms of the variations in types of exchange control prevailing in other countries, and partly in terms of what the countries entering into trade agreements with the United States could be induced to accept in return for the tariff concessions offered in these agreements by the United States. It should be understood that whenever any of the following provisions appear in an American trade agreement, it is phrased in terms of mutual obligation by the two parties to the agreement, and that in general when an agreement refers at all to exchange control it will contain more than one of the provisions listed below :

(1) Pledge to the United States of unconditional most-favoured-nation treatment, with specific reference to exchange control.

(2) Pledge to the United States that it will be "given a fair and equitable share" in any allotment of foreign exchange.

(3) Pledge that in general the exchange control will be administered so as not to influence to the disadvantage of the United States "the competitive relationships" between American commodities and like commodities of third countries.

(4) The United States to be allotted as a minimum with respect to all imports as large a percentage of free foreign exchange as the proportion which the total value of imports from the United States was of total imports from all countries during a preceding "representative period" not further defined in the agreements as published.

(5) The import of any commodity from the United States to be given no less favourable treatment with respect to rates of exchange, taxes or surcharges, or rules and formalities connected with exchange control than *any like* import from any third country.

(6) The import of any commodity from the United States to be given no less favourable treatment with respect to rates of exchange, taxes or surcharges, or rules and formalities connected with exchange control than *any* import whatsoever from any third country.

(7) No secret quantitative restrictions or allotments of exchange to be made.

(8) No use to be made of exchange-control measures involving the use of exchange rates higher than those which would result from the free operation of supply and demand in the market.

(9) No import licenses or other quantitative restrictions to be imposed on specified commodities imported from the United States.

It is clear that these provisions range in character from such as merely impose a general (and vague) obligation on the signatory government not to apply exchange-control provisions to imports from the United States in such a manner as to discriminate unfavourably against American commodities to such as would make the application of exchange control to commodity imports from the United States virtually impossible. For the most part, however, they are in nature such as to protect American exports against unfavourable discrimination through exchange control rather than as to lead to the abolition of existing or to prevent the establishment of new exchange controls.

Information is not available to provide a basis for appraisal of the actual working of these provisions in practice. Even, however, if they have been carried out in full good faith and have worked to the complete satisfaction of the United States, they fall far short of a satisfactory solution from the world point of view of the problems arising from the use of exchange control as an instrument of direct regulation of trade. The United States has succeeded in negotiating trade agreements containing such provisions with only a minority of the countries maintaining comprehensive exchange control, and with Germany and Japan no attempt was even made to open negotiations. In general, the stronger provisions were accepted by countries which were not applying exchange control to commodity transactions or by countries with respect to which the United States was in a particularly strong bargaining position. The general policy of the United States of avoiding in her trade-agreement negotiations any request for allotment of available dollar exchange to the liquidation of outstanding commercial or financial indebtedness tended to make countries debtor to the United States more willing than they would otherwise be to remove or relax their restrictions on the use of their dollar assets in payment of current commodity imports from the United States. Other creditor countries with less bargaining power, or who rated more highly the importance of collection of outstanding debt as compared to maintenance of current commodity exports, would find it harder, other things equal, to obtain removal or relaxation of exchange-control restrictions on payments for their exports. The grant to the United States of unconditional most-favoured-nation treatment with respect to exchange control might in practice mean, not that discrimination between countries was eliminated, but only that the United States shared in the special favours granted to the country receiving most preferred treatment. Where "non-discrimination" took the form of assurance to the United States of as large a proportion of the trade as she enjoyed during an earlier "representative period" (its representativeness being a matter for agreement as between the two negotiating countries only), the consequence would be the freezing of a *status quo*, which might no longer be appropriate to prevailing circumstances. Unfortunately, the American trade negotiations made little contribution to the formulation of specific and logical criteria, capable of routine generalization to third countries, of unconditional most-favoured-nation treatment or of "non-discrim-

ination” with respect to the operation of exchange controls. The “representative period” formula is clearly inadequate for this purpose in the absence of even approximate standards of representativeness under changing conditions, and can under some circumstances lend itself to unfair discrimination against third countries.¹

The provisions relating to exchange control inserted in its trade agreements by the United States represent, nevertheless, the most important, if not the sole, contribution made by any country to protect world trade against the injurious effects of the exchange controls of other countries when used as an instrument of trade regulation and especially when used in a discriminatory manner. The United States, of course, was primarily interested in protecting its own trade from such injurious effects. But those provisions which made the application of exchange control to any imports impossible or difficult and those provisions which stipulated that there should be full publicity with respect to the allotment of exchange or of import licenses would redound to the benefit of all third countries not in a position to insist upon specially favourable treatment. Even the provision guaranteeing most-favoured-nation treatment to American exports would operate to promote general equality of treatment, since a country *A* would ordinarily be more willing to generalize to all countries any favour granted to another country *B*, or would be less willing to grant any favour specially to *B*, if it was bound automatically to extend to the United States any favour granted to *B*. It seems clear that if several important countries, and not the United States alone, were to insist in their trade negotiations upon the inclusion in the resultant agreements of provisions similar to the stronger American ones, and if these provisions could be relied upon to be carried out in good faith, the possibilities of the use of exchange control to enforce bilateralism or other discriminatory trade restrictions would be narrowly restricted.² The greater the number of countries to which any particular country was bound to give unconditional most-favoured-nation treatment with respect to exchange-control practices, the less

¹ See *infra* for a fuller discussion of the “representative period” formula in connection with its application to import quotas.

² The pledge given by the Argentine to the United States, in the agreement of October 14, 1941, of equal treatment with respect to exchange rates, etc., was made subject to the exception of the special exchange facilities extended to the United Kingdom until such time as it became possible for Argentina freely to convert its sterling balances.

would be the willingness of that country to give specially favourable treatment to any country. And the greater the number of countries which practiced unconditional most-favoured-nation treatment among themselves, but did not extend it, or did not commit themselves to extending it, to countries which discriminated against them, the less would be the attractiveness and the feasibility of using discriminatory trade practices for countries which had not bound themselves to equality of treatment. Except for the possibility of treatment of the problems of exchange control through multinational conference, the American procedure seems to be the best available for dealing with the problem. But there is no reason to expect it to be genuinely successful unless it is adopted by a number of important trading countries, and some authorities insist that nothing short of general multinational agreements can provide a substantial remedy for the problem. Its effectiveness, moreover, would be increased if in bilateral agreements containing provisions of the American type there were also included a provision that neither party would seek from a third country, with respect to its export of any commodity of which the other party was also an exporter, any special favour or advantage which was of such a character as to be impossible of extension to the other party to the agreement. If such a provision were added to the provisions of the American type, countries would be bound not only not to discriminate in their own markets but also to avoid seeking preferential treatment in the markets of third countries.

III. IMPORT QUOTAS

FORMS OF QUOTAS AND METHODS OF ALLOCATION

Import quotas are restrictions on imports formulated in terms of maximum quantities of specified commodities which may be imported per unit period. The quantities are almost always expressed as absolute numbers of physical units, but are occasionally specified in value rather than physical quantity terms. In quota provisions included in trade agreements, the size of the quota allotted to particular countries is usually stated in terms of percentages of total imports, but is occasionally stated in terms of percentages of previous imports from the countries in question, or in absolute terms. The quotas may be "global" or without allocation as to source, but are more often allocated by countries.

When the quotas apply only to the quantities which may be imported at specified minimum rates of duty, additional imports being admitted without limitation subject to payment of higher rates of duty, they are called "tariff quotas" (or "*contingents douaniers*") and are to be distinguished from "absolute quotas," which cannot be exceeded on any terms. It is often maintained that tariff quotas are different in principle from absolute quotas. They do constitute a lesser deviation from the principle of regulation of imports by free-market process subject only to the impact of ordinary import duties. But when, as is not infrequently the case, the rates of duty at which imports in excess of the tariff quotas can be imported are in fact prohibitive of import, or nearly so, there is little or no difference in principle or in economic effect between tariff quotas and absolute quotas.

In some cases, the quotas, instead of being applied directly to importers (or to exporters in the country of origin) are applied to domestic processors, as, for example, in the form of percentage restrictions on the maximum amount of foreign grain which may be mixed with domestic grain by domestic millers in making flour, or the minimum amount of domestic alcohol which gasoline refineries must use. The term "indirect quotas" has been used to denote quotas of this type.

When quotas are granted to other countries in trade agreements, these quotas are ordinarily merely permissive, i.e., exporters in the countries receiving these grants are permitted to market in the grantor countries the commodities specified in the quantities specified, but it is left to them to find buyers. There has also, however, been some resort to "guaranteed quotas," commonly called "purchase-agreements," where the grantor country agrees to buy within the stated period the stated quantities as minima. To carry out such pledges, it is necessary either that government import-monopolies or private import-monopolies under official sanction or supervision be set up. Guaranteed quotas seem invariably to have been intended to be discriminatory in practice, and they are the type of quota which it is most difficult to reconcile with the principle of equality of treatment in foreign trade.

In a substantial number of instances, importing countries which have wanted quantitative restrictions to apply to their imports have persuaded or coerced the exporting countries to enforce the desired quantitative restrictions. Such arrangements are commonly referred

to as “gentlemen’s agreements” (“*contingents aimables*”). The motive on the part of the importing country for the adoption of this procedure is sometimes simply to shift elsewhere wherever possible the onerous and often unpleasant burden of allotment of quotas to particular importers. In other cases it is adopted because the executive branch of the government in the importing country lacks the statutory authority to enforce import quotas or, having such authority, is reluctant to use it openly because of possible unfavourable political repercussions at home or because of the danger that once the precedent had been established of applying such quotas it would be forced by special interest pressures to carry the procedure further than it wishes. Under some circumstances, however, there are distinct and important advantages of an economic or administrative nature in having the quotas applied in the exporting countries rather than, or as well as, in the importing country. The export trade may be more concentrated than the import trade, with respect to either number of firms involved or location, or both. The application of quota restrictions can in such cases be more effectively policed against evasion and against the tendency, because of multiplicity of ports of entry, for imports to overrun the maximum quantities sanctioned by the prescribed quotas before the customs authorities can become aware of the fact, and shipments can be better adjusted to seasonal or other variations in market conditions, at the export stage than at the import stage. Control at the export stage is particularly convenient in trades where shipments are commonly made on a consignment basis at the exporters’ risk, where storage facilities are superior at the export points than at the points of import, and where trade practices and the nature of the commodity are such that ascertainment of the country of origin of shipment on the part of the customs authorities of the importing country is necessary for proper allocation of quotas by countries but would be difficult without cooperation of the exporters. In some cases also the use of the “gentlemen’s agreement” procedure in the administration of quotas has been associated with the promotion or sanction by governments of international producers’ ententes or agreements for the sharing of markets and the regulation of the level of competition.

The consent of the governments of the exporting countries or of the associations of exporters to undertake the task of administering or sharing in the administration of the quotas may of course be given

only because of the fear that if they withhold such consent the restrictions on their exports would be made even more severe. Their voluntary participation in the control, however, generally brings some genuine benefits to them, and there have been instances where the request that the exporters administer the quota has come from the exporting country. In the first place, it gives the exporters an opportunity to present their views and to negotiate for better terms or arrangements when the quotas are being initiated. Secondly, quotas tend to result in the market price in the importing country exceeding by a substantial margin the market price in the exporting country plus the cost of shipment including ordinary import duties. Who gets this margin, and, in particular, whether it goes to the exporters or to the importers, will depend mainly on which of these are the recipients of the particular quota allocations. If the allotment of quotas as between individual firms is controlled in the exporting country by or on behalf of an exporters' association or cartel, this margin will accrue wholly or largely to the exporters rather than to the import firms. On these terms the exporters may not only be willing to undertake the task of administering the quotas, but they may even welcome the introduction of quotas and so refrain from pressing their governments to take retaliatory action. The producing interests in the importing country, moreover, may also welcome such agreements because the alternative may be no quotas at all and because their own prices will be less subject to pressure from cheaper imports if the exporters are organized to charge the highest prices which are consistent with full utilization of the quotas.

In some cases in Europe, there have been agreements between producers' cartels in the exporting and importing countries, sanctioned or tolerated by the governments concerned, under which quota provisions have been prescribed on an unofficial basis, as part of a general agreement for sharing of markets on a monopolistic basis, and for suppression of price competition and "reciprocal dumping," and for a sharing of the gains resulting from the elimination of sales at dumping prices.¹

The indicated lack of concern of the governments of the importing

¹ These "gains," except as they result from the elimination of cross-freights, are of course not genuine gains from a public point of view, but are at the expense of importing firms, of consumers, or, in the case of the avoidance of payment of tariff duties through elimination of reciprocal dumping, of the national treasuries.

countries when they enter into or sanction such "gentlemen's agreements" as to where the margin between the prices in the export country and the prices in the importing country goes may seem strange. It is more understandable, however, if it is noted that agreements of this nature first became fairly common during a period of extreme depression, when the predominant interest of governments was not in customs revenues or in low prices to consumers but in protection of the internal price structure and of domestic employment against the deflationary impact of foreign competition.

In a few cases, most notably in the United States, no attempt is made to allocate quotas as between particular importers; imports are admitted on the principle of first-come-first-served until the quota for a particular country, or the global quota, or the unassigned residual quota, as the case may be, is exhausted. In other cases, as we have seen, the assignment of the quotas to particular firms is by agreement handled in the exporting countries. In most cases, however, import licenses or permits are an integral part of the quota system, with the licenses granted either by a government agency or by an authorized importers' cartel or trade association to whom the power has been delegated. Not all cases of import licenses, however, are associated with the quota system. Where the licenses take the form of "exchange quotas," or rights to purchase and transmit or to make commitments for transmittal of specified amounts of domestic or foreign exchange, they are associated with the exchange-control system rather than with the quota system proper. There are, moreover, many borderline variants. In the case of Iran, for instance, the tariff, exchange-control, and import-quota methods of regulation of foreign trade have been combined to form one closely-integrated system by requiring most categories of importers, before they are permitted to withdraw goods from customs: (1) to pay the regular import duties; (2) to present import permits in accordance with the quota regulations; and (3) to present certificates of export (by themselves or by others) of Iran products of a value equal to the value of the imports. In some countries, importers have been required to apply for import licenses prior to making any purchase commitments abroad, and the applications have been granted or rejected in accordance with "secret quotas," or quotas which are not publicly announced.

Instances of the establishment of import quotas can be found at least as early as 1844. But until 1914 very little use was made of this

device, and where it was used it was almost wholly in the tariff-quota rather than the absolute-quota form. During the World War of 1914-1918, extensive use was made of import quotas as a means of limiting imports to essential requirements so as to conserve foreign exchange and shipping. Most of the wartime quantitative restrictions on imports were repealed soon after the Armistice, but a few of these restrictions survived; and in the 1920's some new ones were introduced, especially on moving picture films and automobiles and, in the form of indirect quotas, on bread-grains and crude petroleum. Under the impact of the Great Depression, the "gold bloc" countries, France, Switzerland, Belgium and Holland, adopted comprehensive systems of import quotas in lieu of exchange controls. Many other countries applied import quotas as a supplement to exchange control, or as retaliation against or for use in bargaining with other countries using import quotas. Still other countries, notably Great Britain and the United States, which refrained from adopting the quota system in general, did apply it to a limited number of commodities, chiefly agricultural. In a number of cases countries were obliged to impose import quotas in order to meet the demands of other countries for preferential treatment or for assured markets for their exports. Except for Iran, there appears to be no country outside the continent of Europe which has made comprehensive use of the quota system, but there appear to be very few countries which have made no use whatsoever of it in recent years.

Absolute import quotas have almost always been applied as an additional restriction on imports over and above pre-existing import duties, and in many cases over and above exchange-control restrictions as well. The establishment of tariff quotas, on the other hand, has in many cases, and especially in the cases of the pre-depression tariff quotas and of the tariff quotas established since 1934 by the United States as the result of the negotiation of trade agreements, been associated with the reduction or removal of a pre-existing import duty. Aside from the possible objective of reducing internal resistance to tariff reductions, tariff quotas have been introduced in connection with reductions in import duties in order to set limits to the extent to which the domestic market could be lost to domestic producers as the result of the reduction of duty and, in the case of preferential reductions of duty, to guard against imports from third countries sharing in the duty-reductions by shipment via the preferred

country and concealment of their true origin. In most cases, the tariff quotas were not intended to be restrictive of imports as compared to the situation prior to their introduction, and were set at levels high enough to permit imports in somewhat greater volume than prevailed prior to their introduction.

ADVANTAGES AND DISADVANTAGES OF THE QUOTA SYSTEM

As compared to ordinary import duties, absolute import quotas had certain real or apparent advantages from the national point of view in meeting the pressures resulting from the great depression of the 1930's. The rapidly-changing conditions called for flexible instruments to deal with them. Ordinary import duties, which in many countries could be changed only by a slow and elaborate legislative procedure, were not as flexible as quotas, which were almost everywhere subject to administrative discretion and could be and in practice were changed periodically at intervals as small as three months or even less. Secondly, the fall in prices in world markets in terms of gold currencies for many staple agricultural commodities and raw materials was so great during the depression that, had countries which adhered to the gold standard endeavoured to maintain the pre-depression competitive position in the home market of their domestic production of these commodities by means solely of increases in their ordinary import duties, they would have had to enact rates of duty whose ad valorem equivalents would have exceeded all historical precedents and would have shocked public opinion at home and abroad.¹ Third, many import duties were "bound" or "consolidated" by treaty and could not be increased without violation of treaty obligations, whereas import quotas were not covered by treaty provisions. Fourth, it was not clear that import quotas were subject to most-favoured-nation obligations, and even when it was conceded or claimed that they were, there were no clear and established standards as to what quota practices were or were not in accord with most-favoured-nation obligations. The use of quotas thus opened the way for discriminatory treatment, and under the conditions of the time the power to discriminate seemed to present possibilities of effective

¹ No country appears ever to have enacted an ad valorem duty exceeding 100 per cent, although in modern times specific duties and combination specific and ad valorem duties whose ad valorem equivalents far exceed 100 per cent are only too common.

use for trade-bargaining purposes. Fifthly, where the major objective in adding to existing trade barriers was to prevent unemployment in domestic industries as the result of increased competition from abroad, import quotas provided a much more definite and certain instrument for regulating the quantity of imports than did ordinary import duties. Finally, during the depression, protection of their price structures was often as much a matter of concern to domestic industries as protection of their physical volume of sales; import quotas, by removing or weakening the incentive of foreign exporters to engage in price competition, removed more effectively than did ordinary import duties the pressure of foreign competition on domestic prices.

Import quotas, of course, also had their disadvantages, even from a strictly national point of view. If the quotas were global, without allocation by countries, the field was left open for competition between different sources of supply for the opportunity to supply the market; but the rigidity of the quota system within the unit quota-periods tended to result in a scramble to import before the quota should be exhausted, with a consequent concentration of imports at the beginnings of the quota-periods and from nearby sources of supply. If without allocation by countries there was allocation by importers in accordance with their previous volumes of import, there tended to result a freezing of an obsolescent *status quo*, with windfall profits to long-established firms and hardship on growing and newly-established firms. If the quotas were allocated by countries, whatever formula was chosen would inevitably be somewhat arbitrary, would be regarded by some countries as unfair, and would tend soon to fail seriously to fit the constantly changing situation. It was impossible, moreover, to devise any formula for allocation of quotas, whether by countries or by importers, which would not involve in greater or less degree the transfer from the competitive process of the market to the arbitrary decisions of particular import or export firms, or of the governments of the export countries to whom quotas had been assigned, the determination of what grades should be imported, what trade channels should be used, and what prices should be charged. Moreover, ordinary import duties are not as complete a barrier to adjustment of the quantity of imports to increased powers of absorption of imports by the home market and to improved business conditions in general as are fixed import quotas. While quotas can be more easily changed than ordinary import duties, a rigid and

unchanging quota would be a much more injurious trade barrier in a period of improving economic conditions than an equally rigid and unchanging import duty of equivalent original import-restrictive power.

QUOTAS AND INTERNATIONAL TRADE RELATIONS

A country which is determined not to practice direct regulation of foreign trade and does not wish to be driven into this practice in order to protect its export trade against discriminatory restrictions of other countries which do engage in such practice will ordinarily find much less ground for objection on this score in the mode of operation of other countries' import quotas than in the mode of operation of other countries' exchange controls.

Import quotas do almost inevitably involve a departure from the principle of equality of treatment in its traditional (and economically correct) sense. Import barriers are strictly consistent with the principle of equality of treatment only if they still leave to competitive market processes the sole determination of the source of imports, so that, whatever the total quantity of imports of any specific commodity, price, quality, and credit-term considerations alone determine where it shall be imported from. Even in the case of global quotas unallocated by country or by import firm a fortuitous advantage is given to the nearest country, and this may be important if the quota-periods are short, if storage in the import country of stocks in excess of quotas is not permitted or is made impossible by the perishability of the commodity, and if the quotas are small relative to the quantities which would be imported if there were no quota restrictions. If the quotas are allotted by countries, whatever principle of allotment is followed can never conform except by accident with what would have been the distribution of the imports by countries of origin in the absence of quota restrictions. This is also true, although to a less degree, if the allotment is by importers, since the import houses will have long-established connections, contracts for exclusive handling of certain lines, and specialized shipping and purchasing facilities which will exercise a substantial influence on the regional source of the imports. There would appear to be no tendency to discrimination in the case of "indirect quotas." The discrimination under the direct-quota system would be at a minimum if the quotas were wholly unallocated, but imports were subject to license and the licenses were

freely transferable and were in practice sold to the highest bidders. This procedure, while not unknown, has been adopted or permitted very infrequently.

The quota system lends itself also to deliberate discrimination between countries because quota provisions are in practice if not in principle outside the scope of outstanding most-favoured-nation treatment pledges which do not specifically refer to them, because there do not exist definite, unequivocal, and generally-recognized standards of equality of treatment with respect to them, and because there has not as yet been time to develop a tradition of non-discrimination in their application as part of the *mores* of international economic relations.

While the fact that the quota system appeared to offer a means of escape from treaty-obligations to refrain from discriminatory treatment of imports as between foreign countries was no doubt a factor in some cases in leading to its adoption, in other cases the system was introduced without any intention, as far as available evidence goes, to make use of it as an instrument of discriminatory trade-bargaining. As will be shown later, moreover, import quotas have not in practice proved to be nearly as effective as exchange control as an instrument for trade-bargaining, whether on a discriminatory or on a non-discriminatory basis. The countries which during the depression adopted a comprehensive quota system in lieu of exchange control, and especially the "gold bloc countries," may not at the time have foreseen that this would prove to be the case. But the quota system, as compared to a full-fledged exchange control, involves much less of a break with the free-market economy, much less departure from orthodox monetary practices, much less interference with private business, a much lighter and simpler administrative burden. These considerations were probably the decisive factor in leading the "gold bloc countries" to choose to retain the quota system in preference to exchange control even after they had fully realized the shortcomings of quotas as trade-bargaining devices.

Unlike the situation in the case of exchange control, moreover, there is no reason why the use of quotas by one country, or even by all other countries, should of itself put any more pressure on a non-quota-using country to adopt the quota system than would the imposition of a trade barrier of any other type of equal restrictive effect. The quota system is not, like the exchange-control system, inherently bilateral

in nature. Even if quota-using countries exploit their quota-granting power for bargaining purposes, there is no particular reason why the return concessions they ask for should also take the quota form. While trade-bargaining has in some cases been used to coerce other countries into resort to quotas, the pressure used by the country of the first instance did not in most cases take the form of a threat of a smaller quota or of no quota at all or the promise of a larger quota on its part. All trade-bargaining, even when confined to ordinary import duties and carried on with strict adherence to the most-favoured-nation principle, has at least a mild tendency to lead to bilateralism, since each pair of bargaining countries will naturally endeavour to restrict their concessions to items which are specially attractive to each other and which will only incidentally and to a moderate extent, if at all, be of advantage to third countries if extended to them gratuitously. Trade-bargaining with respect to quotas need not go further than this in the direction of bilateralism. Examination of recent experience with the use of quotas as a trade-bargaining instrument indicates that it is difficult to carry it far in this direction even when there is full readiness and intent to do so.

The most systematic attempt to use the allocation of quotas as between countries as an instrument of trade-bargaining was on the part of France. She succeeded in obtaining important concessions in return for specific quota allotments, and by the introduction of quotas she regained freedom to use for bargaining purposes her imports of commodities on which by previous trade agreements the ordinary tariff duties had been "bound" or "consolidated." But protests by other countries that her method of allocating quotas was unfairly discriminatory were frequent. Great Britain imposed in 1934 severe additional duties on imports from France in retaliation against French preferential quotas in favor of the "gold bloc countries" and the United States. In 1936, in order to obtain a satisfactory trade agreement with the United States, France found it necessary to concede to the United States "original" quotas calculated on the "proportional" or "representative period" basis as well as "supplementary" quotas or fractions of the unused portions of other countries' "original" quotas. The allocation of the "original" quotas on the "representative period" basis narrowly restricted the possibility of their further use for bargaining purposes, while the fact that it was only the "supplementary" quotas which were allotted on a non-propor-

tional basis did not remove the objections of third countries to such allocation as being discriminatory.

Great Britain appears on the surface to have had considerable success both in obtaining preferential quotas for her exports from countries highly dependent on the British export market and in using her own quotas in discriminatory fashion to drive hard bargains with other countries, while continuing to insist upon the receipt of most-favoured-nation or "equitable" treatment from countries with which she had not succeeded in negotiating specially favourable arrangements. The process of gaining these "victories" in trade-bargaining, however, was obviously not an easy nor an altogether pleasant one; to the outsider it seems clear from the record that resentments were accumulating and that defensive and retaliatory measures were generating which would before long have resulted in serious controversy. For Great Britain also, as a trade-bargainer with other countries, there was the special complication that the Dominions regarded preferential access to the British market as a birthright, were not wholly satisfied by the preferential treatment they were given under the Ottawa agreements, and looked with an especially jealous eye at any concessions which Great Britain granted to non-British exporters of agricultural products.

The United States, while she has resorted to some extent to the use of import quotas, has on the whole taken the position that they are undesirable as a permanent institution and that when emergency conditions or special circumstances make it expedient or unavoidable to resort to them they should be administered in as non-discriminatory a fashion as possible.¹ The unfavourable bargaining position of the

¹ A statement of "Policy of the United States Concerning Generalization of Tariff Concessions," issued by the Department of State on April 1, 1935, contained the following reference to import quotas: "With respect to quantitative restrictions, what is meant by non-discriminatory treatment, although somewhat less obvious and subject to different interpretations, can be defined with a fair degree of precision. While the undesirability of quotas is generally agreed to, it is necessary, as long as they are in use, to define the term 'nondiscriminatory treatment' as applied to them. If quotas can be reconciled with nondiscriminatory treatment, this term must be defined as meaning the allotment to any foreign country of a share of the total quantity of any article permitted to be imported, equivalent to the proportion of the total importation of the article which that foreign country supplied during a previous representative period. By 'representative period' is meant a series of years during which trade in the particular article under consideration was free from restrictive measures of a discriminatory character and was not affected by unusual circumstances such as, for example, a crop failure in the case of an agricultural product. The term 'representative'

United States was no doubt a major factor—as it has been since 1922, when she first adopted the policy of equality of treatment in trade matters—in explaining her opposition to discriminatory trade barriers. In trade negotiations with other countries, she has sought to protect herself against unfavourable quotas by obtaining pledges that no quotas be imposed or that no secret quotas be imposed or that if quotas have been granted to third countries there be allotted as quotas to imports from the United States of similar commodities percentages of the total imports of these commodities no smaller than the percentages which imports of these commodities from the United States were of total imports in some previous “representative period.” When the United States has received in trade agreements promises of specific quotas, presumably at her request, these quotas have as a rule been based on the “representative period” formula. But in some instances the United States has received quotas on a basis which it would be either physically impossible or impossible without raising the global quota to apply uniformly to all other countries, and which must therefore be regarded as preferential quotas.

It can be said for the “representative period” formula that it comes closer to a generally applicable formula which would prevent deliberate discriminatory treatment in the allotment of quotas by countries than any other formula which has so far been used or suggested. The formula, however, is far from an ideal one, and it has serious defects both from a theoretical and from a practical point of view.

The chief difficulty is with respect to the ambiguity of the formula. As has already been indicated above, the “representative period” has been defined by the Department of State as “a series of years during which trade in the particular article under consideration was free from restrictive measures of a discriminatory character, and was not affected by unusual circumstances such as, for example, a crop failure in the case of an agricultural product.” In the United States-Peru trade agreement of May 7, 1942, the pledge of allotment of quotas on the “representative period” basis is qualified by the words, “account being taken in so far as practicable of any special factors which may have affected or may be affecting the trade in that article.” It is obviously impossible to determine a “representative period” so defined or so qualified in any wholly objective and precise way, and

tative’ is thus flexible enough to take into account all circumstances affecting the trade in any given commodity with any particular country.”

the choice of what is to be taken as a "representative period" will in practice give substantial leeway to the first negotiators. In the American procedure, the determination of the "representative period" is a matter of secret negotiation between the two parties. While there is official public notice later of the quotas received by the United States, there is as a rule no explanation of how the determination was made. If, as is probably the case, and as would be reasonable where selection of the "representative" period is made a matter for bilateral negotiation, different "representative periods" are used for different countries, late-comers in the process of negotiation and countries not engaging in trade-bargaining would be liable to find that previous percentage allotments of the total imports left little or no residual available for them, the "representative periods" for the early bargainers having been so determined as to absorb all or part of the previous shares of the late-comers in the trade of the quota-granting country. Since gross discriminations in the allotment of quotas are more likely to result from bilateral negotiations than to be established autonomously by the importing country, it would probably conduce to a more objective selection of the "representative" period if this were fixed in each instance by autonomous action of the importing country and were made uniform for all countries.

There is also the basic objection to the "representative period" basis for allocation of quotas that in a time of marked disturbance in price structures and in conditions of trade and production, no previous period may supply even a tolerable, let alone an ideal, basis for present allocation of imports; and that original allocations, whatever their basis, are liable to grow more and more arbitrary and out-of-line with the competitive position of the different countries with the passage of time. Either therefore there is a freezing of an obsolete status, or there must be periodic renegotiation of the choice of period to be taken as representative, with repeated opportunity for deliberate but disguised discrimination as between different countries.

There are other defects, probably not of minor importance and not readily susceptible of correction, in the allocation of quotas on the "representative period" basis. Such allocation calls for the existence of commercial statistics of a greater degree of detail and accuracy, particularly as to classification of commodities and differentiation of country of ultimate from country of immediate origin, than are generally available. The lack of consistency in these respects between

the commercial statistics of different countries provides abundant opportunity for international controversy and for concealed discrimination. Any system of allocation of import quotas by countries, moreover, imposes upon an importing country, *A*, the burden of determining the real origin of all imports subject to quota if it is to protect country *B* from having some of its quota stolen from it by country *C*, through shipment of part of its exports to *A* via *B*. As in the case of preferential duties, rigorous protection of the allocation of quotas would call also for prescribed percentages of the value of specific imports from a particular country which must represent "value added in manufacture in that country" or its equivalent to make those specific imports eligible under that country's quota. Enforcement of such provisions is an onerous administrative burden and involves serious damage to entrepôt and "finishing" trades, but failure to enact or enforce them can undermine the whole allocation process and make its chief result the subsidization by the consumer in the importing country of the use of roundabout and expensive trade routes.

Whatever its defects, however, it must be conceded to the "representative period" formula that it is likely to be in practice a substantial barrier to gross and deliberate discrimination in the allotment of quotas, and that it is in this respect superior to any other formula or practice in the allocation of quotas except the method of sale of import permits to the highest bidder¹ or the use of "indirect quotas" without specific allocation by countries. The defects of the formula, moreover, could be appreciably lessened if the following rules, or something approximating them, could be made standard practice:

- (a) there should be no secret quotas;
- (b) the basis upon which quotas have been allocated should be made public at the same time as the quotas are announced;
- (c) the allotment of quotas as between countries should be retained as a governmental function and should not be delegated or be

¹ There is prevalent a strong prejudice against such a procedure, and the United Kingdom, in particular, has sought pledges that import licenses should not be transferable. From the point of view of the exporting country this procedure may be regarded as objectionable because it provides the most effective guarantee possible that any margin of domestic price over foreign price will accrue to the importing country rather than to the exporters. It is not obvious what other objections can be made against this procedure.

permitted to be exercised by any non-official agency such as a cartel or trade association;

- (d) whatever basis is used in allotment of quotas to any country in accordance with the "representative period" formula should not be inherently incapable of extension to at least all the major foreign sources of supply of the particular commodity involved;
- (e) in trade agreements countries should agree not only not to discriminate against each other in their own quotas, but also not to seek preferential quotas in third countries for commodities in which the other country also is interested as an exporter.

Adherence to these rules would still leave the way open for discrimination in effect as between countries by such procedures as granting generous global quotas for commodities in which country *A* was specially interested and scant ones for commodities in which country *B* was particularly interested. But discrimination of this sort is equally possible in the case of ordinary import duties even under full operation of the most-favoured-nation principle, and no effective barrier against this type of discrimination seems to be available except the total removal of national trade barriers. If the quota system were practised only in conformity with these rules, it would not be open to the objections which can be made against the exchange-control system: that it facilitates deliberate discrimination between countries; that it favours bilateral as against multilateral trade; and that its practice by some countries exerts pressure on other countries to follow suit in self-defense. There would still, of course, remain economic grounds on which countries not themselves using import quotas could object against the substitution by other countries for ordinary import duties of import quotas of equal effectiveness as barriers to imports, of which the two following seem the most important: (a) because quotas are susceptible of and indeed call for more frequent change than do import duties, they involve greater uncertainty for export industries in other countries; and (b) the allotment of quotas on any historical basis operates to freeze an existing or a previous *status quo* and therefore operates to the special prejudice of countries with a growing capacity for or need for foreign trade by preventing either the importing country or the exporting country, or both, from reaping

the advantages, in the form of lower prices, or increased quantities, or both, of a decrease in production costs in the exporting country.

IV. GOVERNMENTS AS FOREIGN TRADERS

TYPES OF GOVERNMENT TRADING

Direct regulation of foreign trade by government is of course carried to its utmost possible extent with respect to the transactions involved when the government is itself the trader and conducts the trading operations through its own agencies. It is in connection with government trading, therefore, that the question of the possible patterns of trade relationship between countries adhering to free-market processes, on the one hand, and countries resorting to direct regulation of trade, on the other hand, comes most sharply into focus, at least in principle. There are different types and forms and different degrees of government trading, however, and some measure of differentiation and classification is necessary as a preliminary to analysis.

Government trading does not necessarily involve government monopoly, complete or partial, in any accepted sense of the term "monopoly." In the ordinary course of their activities all governments are purchasers of equipment, machinery, supplies, etc., some of which will normally be of foreign origin. Whenever governments purchase commodities of foreign origin, whether for their own consumption or for resale, we have instances of government trading in the import field. For present purposes, moreover, it is not necessary that the concept of government trading in the import field require that the government itself be the actual "importer" in the narrow technical sense of the term: the origin of the goods bought by the government and not the location of the market where the government consummates its purchase transactions is the crucial test. We have complete government monopoly, however, only if the government is the exclusive purchaser of all of the commodity in question that is imported, and we have partial government monopoly, only if the government, while not the exclusive purchaser, is the purchaser of a substantial proportion of the imports.¹ The monopoly may be designated as general, com-

¹ In the technical economic sense, for "partial monopoly" to exist the additional condition has to be met that the government purchases of the import commodity are a sufficiently substantial proportion of the total available foreign supplies of that commodity that variations in the amounts purchased by that government will exert

prehensive, or special, according as all imports, a substantial range of imports, or only a few specific commodities are under monopoly control.

Governments also conduct trade as sellers and exporters, chiefly in connection with special export controls over commodities whose world supply comes in large part from territory under their jurisdiction. Government export monopolies in some respects come logically within the scope of this memorandum. They will nevertheless not be dealt with specifically here, primarily because they have been commonly treated as a distinct problem and have been made the subject of an extensive literature.

Private import or export monopolies, whether of the trust or the cartel form, will also not be dealt with here even where these monopolies are sanctioned or promoted by governments, and even where they are "legal monopolies" in the sense either that competition with them by other nationals is prohibited by law or, in the case of cartels, where the obligations of the members to act in a non-competitive manner are enforceable in the municipal courts. The line between government monopolies and private monopolies is often a shadowy one and governments sometimes execute national monopolistic policies by means of quasi-private organizations. It is true also that in some important respects relevant for this memorandum regulation of foreign trade by national cartels or trusts raises issues for other countries substantially similar to those arising out of the direct regulation or the actual conduct of foreign trade by governments. But as it has been customary to treat the trust and cartel problem in relation to international trade as a separate problem, and as the subject has an extensive literature of its own, it will not be dealt with here.

With the exception of the Soviet Union, where both import and export are conducted solely by State agencies, of the governments of belligerent countries during the first world war and the present war, and of the governments of certain minor colonial areas, the purchases by governments ordinarily constitute but a small part of the aggregate purchases made within the area concerned, and only a small part of this in turn consists ordinarily of foreign goods. In times of peace at least, therefore, there has been with the sole exception of the Soviet Union no important modern instance where government purchases

an appreciable influence on its price. In the remainder of this memorandum, this will be assumed arbitrarily to be the case.

bulked so large in the total purchases of foreign goods within a particular country that the problem of general or of comprehensive government import monopoly has arisen for other countries with which it had trade relations. But even when no question whatsoever of monopoly in either the legal or the economic sense arises, the principles which governments as purchasers follow with respect to foreign commodities are of interest to other countries. There have been many instances, moreover, of special import monopolies both in the sense that import of specific commodities is legally restricted to import by or on behalf of government agencies and in the sense that the purchases of these commodities by governments are sufficiently important to exercise an appreciable influence on their prices in some or all export markets.

PRACTICES OF GOVERNMENTS AS TRADERS

While no comprehensive survey of the practices of governments with respect to purchases of foreign goods for their own use or for resale seems ever to have been made, it is well known that governments rarely follow the rule of buying in the cheapest market without regard to any other consideration. In the first place, governments not only commonly make themselves subject to or are by legislation made subject to the payment of the ordinary tariff duties on commodities purchased by or for them, but they frequently go beyond this as a matter of administrative practice, or, as in the United States, in accordance with statutory requirements, and give to domestic sources of supply additional substantial preferences with respect to prices when necessary to put them beyond the reach of competition from supplies from foreign sources. The shift of economic activity from private to government auspices thus tends automatically to increase the barriers to foreign trade.

Secondly, in many countries there exist, for fiscal or sumptuary reasons, internal state monopolies of manufacture or of sale to consumers of particular commodities, such as tobacco, alcoholic liquors, salt, and matches.¹ Where the commodities concerned, or the materials

¹ In the Report of the League of Nations Committee for the Study of the Problem of Raw Materials, 1937, it is said of these fiscal monopolies that: "Monopolies of this kind fall within the sphere of internal policy; and the Committee felt that it was not called upon to subject them to any particular examination." Although the line between matters which are wholly of domestic concern and matters which are of sufficient concern to other countries to be properly subject to international discussion

from which they are manufactured, come wholly or largely from abroad, the governments operating such monopolies may be substantial enough purchasers in the markets of other countries, at least for some distinctive grades or varieties or sources of supply of the commodities concerned, to be capable of exercising a "monopsonistic" or buyer's-monopoly effect on price, i.e., to be able to buy on better terms than if under otherwise similar circumstances the purchases were made by a number of merchants acting independently of each other, without there necessarily being any offsetting economies or other advantages for the sellers. Where such monopolies are efficiently managed, it may be taken for granted that some attempt is made to exploit this possibility.

Third, where government and importer are identical, discrimination between sources of supply, whether for political reasons, to use to maximum advantage the possibilities of monopsonistic buying, or as an item in trade-bargaining, is facilitated in several ways. The process of discrimination can readily be carried on administratively without need of special legislation, without publicity, and with all the flexibility that there may be occasion to use. If the State monopolies are set up as separate administrative units with substantial autonomy, and without close integration with the agencies in charge of political and commercial policy, this may in practice constitute a substantial barrier to the use of their operations for political or trade-bargaining purposes, but other countries can never be confident that such will be the case.

Because, therefore, governments tend to apply in their own purchases a greater preference for domestic over foreign sources of supply than they impose on private purchasers, because governments as purchasers are more frequently than private firms in a position to exert a monopsonistic influence on prices, and because when governments are themselves the purchasers of the imported commodities they can more readily bring into play political or commercial-policy reasons for discrimination between different foreign sources of supply than when they must operate, if at all, only through the regulation by tariffs or other devices of the purchasing activities of private

and negotiation is not easy to draw, and its location is subject to change with time, it is clear that the purchasing practices of fiscal monopolies which are important purchasers of foreign commodities are legitimate subjects of concern to other countries and should not be withheld from international discussion merely on the ground that they are in some sense matters of "internal policy."

traders, for all of these reasons the operations by governments as purchasers of foreign goods, when they are substantial in scale, are properly a matter of special concern to other countries which are exporters of the commodities in question.

Both in the case of ordinary government purchases and in the case of the purchases of special government monopolies, bargaining by exporting countries to obtain specially favourable treatment for their products appears to be infrequent, although it is known that arrangements of this sort made in connection with the negotiation of comprehensive bilateral trade agreements have sometimes been left out of the texts of the agreements as published. At least a few instances, however, of preferential arrangements with respect to government purchases are a matter of public record. During the 1920's, France obtained in her commercial agreements with the northern European countries maintaining state monopolies of the sale of alcoholic beverages pledges that purchases of types of beverages which France could supply would be made exclusively in France, and Portugal and Spain obtained "purchase agreements" or guaranteed import quotas for their wines from several of these countries. In 1933 the United Kingdom obtained from Norway a pledge as to the maximum prices at which British whiskey would be sold to consumers by the Norwegian state liquor monopoly. In the same year, as an "understanding" supplementary to the published trade agreement between the United Kingdom and Denmark, the latter country undertook that in the case of purchases by the central government and also for purchases by municipal governments in so far as the central government could influence them the first offer of orders should be made to British firms; in the case of central government orders, British firms were to be given a preference of 10 per cent. In the commercial agreements between the United Kingdom and the Soviet Union, the latter agreed to purchase British products and shipping services each year corresponding in value to stated percentages of the value in that year of British imports from the Soviet Union. In the annual series of commercial agreements between the United States and the Soviet Union beginning in 1935, the Soviet Union undertook to make as a minimum specified aggregate purchases in the United States. Provisions of the kinds illustrated above are all either unqualifiedly preferential or are at least inherently incapable of complete generalization to all foreign countries.

PLEDGES OF NON-DISCRIMINATION IN GOVERNMENT PURCHASES

The growth in recent years of the importance of governments as importers has drawn attention to the question of whether it is possible for exporting countries to obtain guarantees of non-discriminatory treatment from governments as purchasers corresponding in purpose and effectiveness to the most-favoured-nation-treatment pledge with respect to trade carried on under private auspices. The question was made the subject of formal international discussion in 1931 in Geneva before the League of Nations Commission of Enquiry for European Union. The representatives of the Soviet Union on this Commission proposed unsuccessfully the adoption by the participating countries of a draft protocol of "economic non-aggression." The signatories to this protocol were to "undertake to forego any discrimination whatever, and to regard as incompatible with the principles of the present Protocol the adoption and application in their respective countries of a special system directed against one or more of the countries signing the present Protocol or not applicable to all other countries." The occasion for the proposal was the fact that many countries at this time of severe depression were showing serious concern about the alleged menace of Soviet "dumping" and some countries had applied or were contemplating the application of special restrictive measures on imports from the Soviet Union on the ground that as a state monopoly of foreign trade it was practicing "dumping" and that the alleged absence in the Soviet Union of any necessity for taking "costs of production" in the private enterprise sense of the term into account in determining the prices at which export sales could advantageously be transacted made the situation of importing countries vis-à-vis imports from the Soviet Union different from their situation vis-à-vis other exporting countries in which export trade was in private hands. The question of Soviet "dumping," which falls outside the scope of this memorandum, was the main issue in the discussion which followed the presentation of the Soviet proposal, but the discussion is nevertheless relevant here because the question of the possibility of obtaining effective guarantees of non-discrimination from countries which conduct their import trade as a state monopoly was there raised. In proposing a pledge of "non-discrimination," the Soviet representatives made it clear that what they had in mind was not the equivalent of unconditional most-favoured-nation

treatment but only the avoidance of the application to a single country or to a small number of countries of specially unfavourable treatment solely because of the political or economic systems followed by such country or countries.

In reporting the unwillingness of the delegates of some countries to approve the Soviet proposal, a special sub-committee of the Commission explained that :

“it was pointed out, in particular, that the consequence of the existence of a foreign trade monopoly in the Soviet Union was that, notwithstanding an undertaking entered into by the State to apply equality of treatment to all the other contracting parties, the same State acting as trader might, at least in theory, infringe its undertaking without its being possible for the injured party to prove any discriminatory intention, since the detrimental situation of which such party would complain would be a natural consequence of the economic system in force.”

The Soviet representatives, in reply to this argument, claimed, first, that the difference between the Soviet Union and other countries with respect to the possible intervention of the State in the economic sphere was not so great as might appear at first sight, given the prevalence in other countries of import and export restrictions, exchange controls, government (special) monopolies, cartels, etc. The Soviet Union moreover, they contended, could give a positive and effective guarantee of non-discrimination, i.e., of non-promulgation of laws prohibiting the purchase of goods in a particular country. They pointed out that in the Soviet Union purchases abroad were made, on the basis of a general plan prepared by the government, by state commercial organizations which “in the absence of special instructions, were to be guided solely by commercial principles, and would therefore buy in the market which happened to be the most advantageous in each particular case.” “It was true,” said one of the Soviet representatives, “that the [proposed] pact does not bind the commercial organizations of capitalistic countries or of the Union never, under any circumstances, to modify the amount of such orders as they have once decided to place. But variations in these purchases after the signature of the pact will depend on purely commercial considerations and will take into account the circumstances of each particular transaction.”

The discussion at the 1931 Conference thus turned only on the question whether effective guarantees could be obtained through international agreement against discriminatory treatment by a state trade monopoly. There does not seem to be much doubt that, if good faith is not to be taken wholly for granted, it would under readily imaginable circumstances be easier for a state monopoly to violate a pledge of non-discrimination without the countries discriminated against being in a position to demonstrate the existence of such violation, or to become aware or even suspicious of its existence, than if the pledge had been made by the government of a country whose foreign trade was wholly in private hands and where government regulation of foreign trade was limited to the imposition of ordinary import duties. If "discrimination," moreover, is given its usual meaning with reference to trade barriers, or its meaning in economic usage with respect to monopolistic practices, it is evident that any agency having monopoly power would be acting in conformity with, rather than be departing from, "commercial principles" and would be buying "in the market which happened to be the most advantageous in each particular case" if it carried out skilfully the practice of "discriminating monopsony," *i.e.*, if instead of buying only in whatever market happened to have the lowest prices, as a competitive private trader would endeavor to do, it bought at higher prices in markets with elastic supplies and lower prices in markets with inelastic supplies, and instead of endeavoring to equalize its purchase prices in different markets it sought to equalize as between the different markets its marginal expenditures per unit, or the net additional outlays for additional units of purchase after allowance for the effect of its purchases on prices. While adherence to "commercial principles," therefore, would preclude wanton discrimination and discrimination from prejudice or on political grounds, it would not preclude operation on the principle of discriminating monopoly. The discussion on both sides, moreover, neglected to take into consideration the fact that the existence of a buyer's monopoly creates for exporting countries a problem, though admittedly a lesser one, even if the monopoly exercises its monopoly power on a strictly non-discriminating basis.

From the point of view of other countries, the problem arising from the shift of purchasing from competitive private auspices to government agencies would have received a wholly satisfactory solution only if the following points were satisfactorily dealt with by

international agreement: (1) disclosure of the extent of preference granted to domestic suppliers over foreign suppliers and limitation of this preference to the rates of import duties on similar commodities imported under private auspices; (2) undertakings not to operate "monopolistically" in the economic sense and especially not to operate on the principle of discriminating monopoly; (3) undertakings not to discriminate on political or other non-economic grounds. Examination of the provisions of a non-preferential nature relating to government monopolies which have appeared in trade agreements indicate that no real progress has as yet been made toward an adequate solution of this problem. The obvious inadequacy for their purpose of these provisions suggests, in fact, that the problem is either inherently incapable of satisfactory solution or that the solution awaits the discovery of logical and practicable formulae in this field.

The commercial Convention between the United Kingdom and the Soviet Union, 1930, contained the following provision:

"In concluding the present Agreement, the contracting parties are animated by the intention to eliminate from their economic relations all forms of discrimination. They accordingly agree that, so far as relates to the treatment accorded by each party to the trade with the other, they will be guided in regard to the purchase and sale of goods, in regard to the employment of shipping, and in regard to all similar matters by commercial and financial considerations only, and, subject to such considerations, will adopt no legislative or administrative action of such a nature as to place the goods, shipping, trading organizations and trade in general of the other party in any respect in a position of inferiority as compared with the goods, shipping and trading organizations of any other foreign country."

What has been said above should suffice to make it clear that a pledge of this character would leave the pledgor free, without violating the letter or the spirit of the pledge, not only to operate on monopolistic principles but to practise discriminating monopoly, provided that the discrimination was not wanton or in pursuit of political or "economic warfare" objectives but was based solely on "commercial" considerations. Presumably also "financial" considerations would justify arrangements on a strictly bilateral basis, under which

countries which were large purchasers would receive more favourable treatment of their exports.

The Commercial Agreement of February 16, 1934, between the United Kingdom and the Soviet Union contained a reciprocal pledge that "without prejudice to any other provisions of this Agreement according more favourable treatment" the products of each country should enjoy in the other "all the facilities, rights and privileges which are at present or may be hereafter accorded to the natural produce and manufactures of any other foreign country, in all that relates to the prohibition and the restriction of imports and exports, customs duties and charges, transport, warehousing, drawbacks and excise." While the specific term is not used, this is a routine most-favoured-nation-treatment pledge. It is scarcely conceivable that either signatory would claim, or concede, that the operation in foreign trade of a state monopoly in accordance with the principle of monopoly pricing, whether in its non-discriminating or its discriminating form, would be in violation of this pledge.

A statement of "Policy of the United States Concerning Generalization of Tariff Concessions" issued by the State Department on April 1, 1935, contained the following reference to monopoly:

"If a country establishes or maintains a government monopoly for the importation or sale of a particular commodity or grants exclusive privileges to one or more agencies to import or sell a particular commodity, the Government of the United States believes that such monopoly or agency should not discriminate against American commerce but that it should accord American suppliers a fair and equitable share of the market as nearly as may be determined by considerations of price, quality, etc., such as would influence a private commercial enterprise."

Most of the trade agreements entered into by the United States since 1934 contain provisions relating to monopoly which follow closely this statement of policy. The following provisions have been used, singly or in combination:

"In awarding contracts for public works and in purchasing non-military supplies, the Government of neither country shall discriminate against the other country in favour of any third country."

"In the event that [either Government] establishes or maintains

an official monopoly or centralized agency for the importation of or trade in a particular commodity the Government establishing or maintaining such monopoly or centralized agency will give sympathetic consideration to all representations that the other Government may make with respect to alleged discriminations against its commerce in connection with purchases by such monopoly or centralized agency.”

“In the event that [either Government] establishes or maintains a monopoly for the importation, production or sale of an article or grants exclusive privileges, formally or in effect, to one or more agencies to import, produce or sell an article, the Government of the country establishing or maintaining such monopoly, or granting such monopoly privileges, shall, in respect of the foreign purchases of such monopoly or agency, accord the commerce of the other country fair and equitable treatment. In making its foreign purchases of any article such monopoly or agency shall *within the quantitative limitations permitted by other provisions of this Agreement*, be influenced solely by competitive considerations, such as price, quality, marketability, and terms of sale.”¹

“In case of a Government monopoly for import, production or sale . . . the Government . . . agrees that in respect of the foreign purchases of such monopoly or agency the commerce of the other country shall receive fair and equitable treatment.

“To this end it is agreed that in making its foreign purchases of any product such monopoly or agency will be influenced solely by those considerations, such as price, quality, marketability, and terms of sale, which would ordinarily be taken into account by a private commercial enterprise interested solely in purchasing such product on the most favourable terms.”

These are vague pledges, and, waiving all questions of good faith, it is doubtful that they have much significance. With one possible exception, pledges of this sort would not impose any obligation on

¹ The words placed in italics by me refer to what for present purposes must be regarded as provisions for “preferential” treatment included in the agreement. This illustrates the difficulty of fitting relations with countries which directly regulate their trade into a non-discriminatory pattern. It is interesting to compare the phrasing here used with the phrasing used in the United Kingdom-Soviet Union Agreement of Feb. 16, 1934, to deal with a similar situation, where the pledge of equal treatment was granted by the Soviet Union “without prejudice to any other provisions of this Agreement according more favourable treatment.” (See *supra*, p. 79.)

a signatory to refrain from exercising what monopoly power it had to influence prices, even in discriminating-monopoly fashion, provided it confined its use of such power to the maximization of its economic gain. It may be that the use in one of the provisions¹ of the phrase "influenced solely by competitive considerations" was understood by the parties to the agreement containing this pledge to mean that any state monopoly was thereby obligated, as far as purchases from the other country was concerned, to refrain from operating "monopolistically," *i.e.*, that in deciding what purchases it should make it was obligated to refrain from taking into consideration the effect of any variation in its rate of purchase of the products of the other country on the prices it would have to pay for the products of this country (and perhaps also for the products of third countries).

Once there is monopoly power, however, there does not seem to be available any general formula, capable of practical application and not somewhat arbitrary, which would restrain the use of that power for economic advantage. When monopoly power is present, its use tends to some extent to be automatic and undeliberate. The existence of the power, even without conscious will to exploit it, is sufficient to yield some monopolistic fruits. Even if an agency with some degree of monopoly power were willing to subject itself to a self-denying ordinance, it would probably encounter great difficulty in drafting such an ordinance and in applying it to its operations. By deciding to buy at uniform prices regardless of the source of supply of its purchases, it could keep itself from practising discriminating monopoly. But unlike a private competitive buyer, it could not prevent the size of its purchases from influencing the price it had to pay, and it could not very well be expected to refrain from being influenced in the determination of the volume of its purchases by the effect on the price of the scale of its purchases. In technical language, a non-discriminating monopoly would set its purchases at the point where its marginal demand for the commodity corresponds to the *marginal* expenditure on it, all purchases being assumed to be made at the same price. A competitive purchaser, on the other hand, would set his purchases at the point (representing, other things equal, a greater volume of purchases) where his marginal demand for the commodity corresponds to its price, or to his *average* expenditure thereon. Moreover, even if

¹ See *supra*, p. 80.

a state monopoly were able to determine the point of equivalence between its marginal demand and price, it seems clear that no other government would be in a position to demonstrate that it had restricted its purchases to a volume short of that point even though such should in fact be the case.

The most that an exporting country could do by agreement with a monopolistically-trading country to protect itself against injury from the latter's monopolistic practices would seem to be either to obtain pledges that the latter would not use its monopoly power for non-economic purposes, would not practice discriminating monopoly, and would not give domestic suppliers more preference than was equivalent to the existing tariff rates (or some other specified rates), or else to make an *ad hoc* agreement with the latter as to specific amounts and terms of trade. The *ad hoc* agreement method, however, means in effect that monopoly is being met by monopoly, and that the bargaining is on the basis of duopoly, or bilateral monopoly. Of the economic mode of operation of duopoly as between governments little more can be said in general terms beyond that, by removing major trade decisions from the market place to government offices, it tends to lead to bilateralism in trade and to the easy injection of political considerations, and that in theory, assuming that resort to genuinely competitive trading under private auspices was a practicable alternative, mutual abandonment of monopoly practices would produce economically superior results for the two countries combined and would in most cases produce economically superior results for each of the countries concerned. If on the other hand the two countries failed to reach a mutually acceptable agreement and each country retaliated against the monopolistic practices of the other in a fighting spirit, the economic damage to the two countries would be at a maximum.

It should be made clear, however, that if the mechanisms of the competitive market have broken down or are working badly, if the markets are pervaded by private monopoly, if private trade would be subjected to high tariff barriers which state monopolies can evade if they wish, the practice of bilateral government monopoly may prove less injurious to the participants than would passive adaptation to the badly-operating, monopoly-ridden, tariff-bound processes of the market place. With respect to government trade monopolies, as with respect to exchange controls and the quota system, the case against them is strong only on the assumption that there is available as an

alternative a smoothly-working competitive market process, not subject to substantial interference by private monopolies and not restricted by tariff barriers more oppressive to trade and more discriminatory than the government monopolies themselves.

V. CONCLUSIONS

Before 1914 international trade relations were conducted for the most part in a favourable setting as compared to the situation during the inter-war period. An international metallic standard prevailed and the stability of exchange rates could be taken for granted. International credit facilities, short- and long-term, under private auspices, were abundant. Trade barriers, although high as compared to earlier levels, were low as compared to those which were to prevail after the First World War and there was almost universal practice of equality of treatment of foreign countries in tariff matters. Barriers to foreign trade other than ordinary import duties were few and of little importance and there was no comprehensive recourse in any country to direct regulation by government of foreign trade.

During the First World War, most of these characteristics of international trade relations either were eliminated by the natural consequences of military operations on a world-wide scale or were deliberately abolished by governments for military reasons. But a widespread and rapid process of restoration of the pre-1914 institutions and mechanisms began soon after the Armistice. By 1929, an international gold standard was again in operation, exchange rates were stable, trade barriers were again confined for the most part to ordinary import duties applied equally to imports from all foreign countries, and long- and short-term capital was moving between countries in unprecedented quantities.

The underlying situation nevertheless was an unhealthy one. Some countries had returned to the gold standard at old parities no longer appropriate to their existing trade status and their internal price structure and without adequate reserves in gold or in foreign-exchange assets. International credit was provided to a larger extent than before 1914 on a short-time basis, although used at least as largely as before 1914 for long-term purposes. Recollections of extreme price-inflations and exchange-depreciations made investors and banks more sensitive to signs of monetary pressure than they had

been before 1914, with the result that much of the international lending was liable to sudden cessation or withdrawal upon the appearance of any symptoms of impending difficulties. The German reparations obligations and the inter-Allied loans constituted large blocks of international debit obligations which were rigid and unresponsive to changes in the basic trade or financial position of the debtor countries. The United States, which was now the predominant source of international credit, was an inexperienced lender. Many of its loans had been made for purposes not adapted to creating the means for servicing the debts and at rates of interest burdensome to the debtors. Tariff levels were higher than ever before, and over-extension of cereal production had reduced the prices of grains in the world market to levels unremunerative for the grain-exporting countries. Increased rigidities in price and cost structures, resulting from social security programmes, from the growth of collective bargaining, and from the extension of monopolistic organization of private business under governmental sanction or tolerance, had lessened the adaptability of the national economies of the industrial countries to downward price-changes in world markets and to international balance-of-payment pressures.

With the onset of the great depression, the fundamental weaknesses in the world economic structure quickly became apparent. International credit facilities dried up. Exports fell drastically in physical quantity and, with respect to raw materials and foodstuffs, also in unit prices. Pressure on the exchange-values of the gold standard currencies became widespread, and defaults on international debts began to occur. Unemployment in the industrial countries reached unprecedented levels.

In the absence of effective concerted action to deal with the problem, each country sought to protect its national economy against further accentuation of the depression by whatever methods and devices were available, without regard to their impact on other countries or on the world economy as a whole. Some countries left the gold standard and allowed their currencies to depreciate. Other countries clung to the gold standard but increased their tariff barriers against imports and introduced import quotas to relieve the pressure on their currencies and to check the deflation under way in their internal markets. Many countries established exchange controls both to pro-

tect their currencies and as means of restricting imports more effectively.

Many of the new measures adopted consisted of or involved the direct regulation of foreign trade. Germany, in particular, established a comprehensive system of exchange-control and made drastic use of it as a trade-bargaining instrument, to facilitate her economic preparation for war, and as an instrument of political and economic aggression against other countries. Most countries had adopted the new measures only as emergency measures, or as a defence against the similar measures of other countries. But as they became accustomed to the new measures and as the prospect of their early abandonment by other countries became less-and-less promising, there was a widespread trend toward regarding them as more-or-less permanent. The gathering war-clouds resulted in their further extension and intensification. When war broke out, the restrictions on world trade were greater in degree, and more discriminatory in form, than in any previous year since 1919. Wartime conditions have led to still further intensification of the direct controls of foreign trade and to their spread over the entire world.

There may be, from the national point of view, a case for national resort to direct foreign trade controls under conditions of world-wide depression, of overvalued and unstable currencies, of collapse of international credit facilities, of imminent threat of war, of the prevalence of similar controls in many other countries, and of absence of any promise of effective concerted action on the part of the major trading countries to obtain relief from these evils. But these direct controls are in general injurious to world prosperity and are barriers to international economic collaboration and to international harmony. Their substantial elimination is a prerequisite for the attainment of a peaceful and prosperous world.

The three major types of direct governmental regulation of foreign trade are: exchange controls applied to commercial transactions; import quota systems; and government monopolies of foreign trade. (A closely-related type not dealt with in this memorandum is the regulation of foreign trade by governmentally-sponsored or tolerated cartels of private business membership.)

Against all three of these, though in different degrees, the charges can be made that:

(1) They tie up diplomacy closely with the detailed conduct of foreign trade and thus promote international controversy and facilitate the harmful injection of political and military considerations into trade relations;

(2) They lend themselves more effectively than ordinary import duties to the application of monopolistic methods to foreign trade, to the economic injury of the world as a whole;

(3) They promote bilateralism in foreign trade, at the cost partly of economically-superior multilateral trade and partly of the suppression of profitable foreign trade;

(4) They lend themselves to discriminatory treatment of the trade of different countries for economic or political purposes;

(5) They promote, or even require for their execution, the development of internal monopolies and the restriction of the field for private enterprise, and especially small-scale enterprise;

(6) By placing other countries not following similar practices in a position of relative disadvantage in trade-bargaining, once established in some countries they tend to spread to other countries.

Some attempts were made during the 1930's to check the growth of these methods, but they proved almost wholly ineffective. Most of the countries which did not welcome the new trends nevertheless felt themselves compelled to adopt some of them in self-defense. The attempt of the United States to check their growth by means of the Hull Trade Agreements Programme, under which concessions were made from the ordinary American tariff rates in return for, among other things, pledges to moderate existing direct controls or not to introduce new ones, or to administer them in such fashion as not to involve discrimination against American export trade, had only a very minor degree of success in obtaining a general amelioration either of the extent or of the discriminatory and restrictive character of the direct controls. Endeavours under League of Nations and other international auspices to obtain multilateral consideration of the situation with a view to finding a multinational solution came to nothing.

Hope for better results from future attempts to obtain reform in this field must depend in part on the attainment, through provisions for collective security, of a reasonable expectation of a peaceful world and therefore on the lessening of the importance of military

and political considerations in the determination of national trade policies. It must depend also on reduction of the levels of ordinary import duties in high tariff countries, on the attainment of substantial stabilization of currencies, on the establishment of procedures for concerted action to deal with the problem of mass unemployment, and on provision of reasonable facilities for international credit, short- and long-term.

Given assurance that the other measures necessary if the post-war world is to have good prospects of being a peaceful and prosperous world will be taken, it is probable that some countries will be willing on their own initiative or by bilateral or other forms of international agreement to abolish outright most if not all of the measures of direct regulation of foreign trade which they adopted during the Great Depression or during the war period. Other countries, however, appear to be too strongly committed to direct regulation of foreign trade, either for its own sake or as a corollary of their practice of direct regulation of their national economies as a whole, to justify any expectation that it will be possible to obtain anything like universal abandonment of direct foreign trade controls. It seems advisable, therefore, while aiming at as much movement in this direction as possible, to give consideration in advance to the procedures which may at the same time lead to the maximum possible degree of abolition of such direct controls and establish for countries not practising such controls on a substantial scale the most satisfactory basis attainable for their trade relations with each other and with countries which continue to subject their foreign trade to rigorous direct controls.

The grosser abuses and evils of direct regulation of foreign trade are, in theory at least, susceptible of elimination or of reduction to minor proportions without requiring total abolition of such controls. In the relations between countries which are anxious to return to multilateralism and to the conduct of foreign trade subject primarily to the regulation of free market forces, substantial progress in this direction should be feasible by means of bilateral negotiation, provided leadership in such negotiation is not left to a single major trading country. From past experience with bilateral negotiation, it seems clear, however, that there will be no ground for expecting substantial and rapid progress unless:

(1) Greater success than has as yet been shown will be attained in formulating and obtaining acceptance of unambiguous, rational, and readily enforceable criteria for determining the absence or presence of discrimination and of the illegitimate use of monopoly power in trade relations;

(2) The participating countries in their bilateral negotiations will give consideration not only to protection of their own export trade from discrimination or from monopoly pressures but also to the need for refraining from pressing for or even from accepting concessions which involve discrimination against innocent third countries; and

(3) There emerges from the bilateral negotiations a common pattern of policy with respect to relations with countries which continue to adhere to rigorous direct controls of their foreign trade.

There is scepticism in some quarters as to whether much progress can reasonably be expected from the method of bilateral negotiation alone in dealing with these aspects of the problem. This scepticism may be warranted. In any case, there would be much more ground for optimism if there could be reasonable hope that the countries at all inclined toward the elimination or substantial reduction of direct controls of foreign trade could be persuaded to attempt to deal with the problem through a multilateral conference. It would be an appropriate objective of such a conference to obtain a multilateral agreement binding the participating countries:

(1) To move toward elimination of direct controls on a mutually-agreed time-schedule;

(2) To define the practices which would not be permissible in the trade relations between participating countries;

(3) To formulate the procedures to be followed in common in trade relations with non-participating countries adhering to direct controls; and

(4) To participate in the setting-up of a continuing international agency, to which questions of violation of the convention, of needed revision of its terms, and of admission of new countries could be referred.

It is conceivable that the sense of mutual advantage from adherence to the provisions of the international convention would suffice to secure the continuance of the agreement and conscientious execution of its terms. It would be a wise precaution, nevertheless, to provide that adherence to the convention should bring with it valuable privileges confined to the adhering countries and that serious departure from its terms, if proclaimed by the international agency to be aggressive or otherwise objectionable in character, should bring costly penalties to participating or non-participating countries. There follow some suggestions as to possible privileges and penalties which might be provided for.

The convention should provide that every signatory country relinquish any claims on other signatory countries which it may have under existing treaties or agreements for most-favoured-nation treatment from other signatory countries, but without obtaining freedom from the obligation to grant such treatment itself, upon a finding by the international supervisory agency that it had resorted to any practice or practices in violation of the convention and of sufficient importance to warrant such penalty.

The convention should further require all signatory countries to terminate at the earliest possible moment consistent with the terms of the relevant treaties any outstanding obligations they may have to grant most-favoured-nation treatment to non-signatory countries and to refrain from establishing new obligations to grant most-favoured-nation treatment to such countries.¹

¹ Such provisions would be similar in principle to, but would go further than, some proposals made in recent years for exempting the concessions exchanged in multilateral agreements of a "liberalizing" character from any obligations of extension to non-participating countries under most-favoured-nation agreements. Cf.: the Resolution presented by Secretary of State Hull to the Montevideo Conference of 1933 and adopted by it: "Art. 1. The High Contracting Parties, with respect to their relations with one another, will not, except as provided in Art. 2 hereof, invoke the obligations of the most-favoured-nation clause for the purpose of obtaining from Parties to multilateral conventions of the type hereinafter stated, the advantages or benefits enjoyed by the Parties thereto.

The multilateral economic conventions contemplated in this article are those which are of general applicability, which include a trade area of substantial size, which have as their objective the liberalization and promotion of international trade or other international economic intercourse, and which are open to adoption by all countries."

Cf. also, the discussion as to the desirability of a provision of this character in

The convention should impose on the signatory countries the obligation not to seek from non-signatory countries, and perhaps even not to accept, any preferential privileges which would operate to the disadvantage of other signatory countries and which were of a kind which signatory countries would not be free to grant under the terms of the convention. In case any country makes use of direct regulation of foreign trade as a means of discrimination between other countries, to exploit a monopoly position as buyer or seller, or as an instrument of political aggression, to the serious injury of any participating country, the international agency to be set up, upon application of such country, should have the power to require all participating countries to take such measures as it prescribes to deal with the situation.

With respect to exchange control, specific safeguards against its use as an instrument of trade regulation, or at least against its use in a discriminatory fashion, could appropriately be provided in connection with the establishment of an international agency for monetary stabilization. Access to the credit facilities afforded by such an agency could be restricted to member countries, and avoidance of any restrictions, or of any discriminatory restrictions, on the use of foreign exchange for the purpose of paying for current imports might be a condition of membership.¹

League of Nations, *Recommendations of the Economic Committee Relating to Commercial Policy*, Geneva, June 18, 1929 (League Document C. 138, M. 53. 1929. II. pp. 13-14), and in *Draft Annotated Agenda of the Monetary and Economic Conference*, January, 1933 (League Document C. 48, M. 18. 1933. II. Spec. I. V, B. (a)), and the proposal submitted to the London Monetary and Economic Conference by Secretary Hull in July, 1933 (League Document M. E. 22 (1), 1933, p. 43).

¹ The draft plan for an international Stabilization Fund issued by the United States Treasury in April, 1943, contains the following relevant provisions:

VI. "Each member country of the Fund undertakes the following:

2. To abandon, as soon as the member country decides that conditions permit, all restrictions and controls over foreign exchange transactions (other than those involving capital transfers) with other member countries, and not to impose any additional restrictions without the approval of the Fund.

The Fund may make representations to member countries that conditions are favorable for the abandonment of restrictions and controls over foreign exchange transactions, and each member country shall give consideration to such representations."

In the British White Paper of April 8, 1943, presenting a plan for an International Clearing Union, it is proposed that:

"In any case, it should be laid down that members of the Union would not allow or suffer among themselves any restrictions on the disposal of receipts arising out of current trade or 'invisible' income."

The technical difficulties of framing and of administering a multi-lateral agreement of this kind would be comparatively moderate if wide acceptance could be obtained for definite and unqualified outlawry of the questionable practices, at least after a transition period had elapsed. If, however, as is likely, many countries will be willing to sign such an agreement only if made subject to important reservations and qualifications, very serious difficulties will result. In the light of past experience, the greatest danger will be that an agreement will be reached with general provisions admirable in form and substance but almost totally deprived of meaning or of enforceability by the detailed reservations and qualifications incorporated in the agreement. A spurious agreement is likely to have even worse consequences than acknowledged failure to reach an agreement, since in the latter case general recognition of the existence of an unsolved problem is promoted, and sober second-thought may lead to a renewal of attempts to reach a genuine solution.

On the other hand, since it will in all probability be a prerequisite for general acceptance of a significant agreement that some provision be made for the particular situation or the special circumstances of individual countries, a rigid convention not allowing of any important exceptions does not appear to be an available alternative. The desirable and conceivably attainable solution of this difficulty would appear to be an agreement whose general provisions were fairly rigorous; but with provision for exemption from these provisions in particular cases upon application to the international supervisory agency and approval thereby.

It cannot too often be repeated, however, that progress in obtaining significant agreement in this field will certainly be difficult and will probably be impossible to achieve except in connection with the reaching of international agreement in other fields of international economic relations. In particular, in order to obtain substantial elimination or restriction of the application of direct controls to foreign trade in an objectionable manner, it will probably be necessary also to reach international agreement for the limitation of the heights of ordinary tariffs, for the establishment of international credit facilities both for monetary stabilization and for long-term investment purposes, and for international collaboration in dealing with the problem

of the business cycle and of mass-unemployment. Slow progress in this, as in the other fields, will not necessarily be fatal, provided that there is early agreement on the direction in which movement shall take place and on procedures of negotiation which will assure that the achievement of one stage of reform will lead promptly to endeavours to accomplish the next stage.

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