Revised Draft
September 12, 1944

PART ONE: SUGGESTED SUPPLEMENTS TO THE DRAFT TEXT OF ARTICLES ON EXCHANGE CONTROL AND DISCRIMINATION AS PREPARED BY THE SUBCOMMITTEE

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INTRODUCTORY STATEMENT

The purposes of the International Monetary Fund, while essential to a large volume and free movement of international trade, are neither the reduction of tariffs, quotas, and other direct barriers nor even, primarily, the elimination of discriminatory practices amongst countries. Such matters were, quite properly, left to the formulators of an International Commercial Policy Agreement.

As a legitimate part of its apparatus, the Fund envisaged exceptions to its proscription of bilateral trade arrangement, exchange controls, etc. In so doing it desired to provide emergency devices for equating the supply and demand for foreign exchange for a particular country without devaluations. Also in so doing it was not concerned with elaborating guarantees that these exceptions should not be discriminatory nor that they could not be used -- outside their legitimate role in equating the supply and demand for exchange -- for purposes of commercial policy, e.g. as a substitute for tariffs. Clearly that was to be the role of the International Commercial Policy Agreement.

If the Scarce Currency and Balance-of-Payments exceptions provided in the Fund are simply accepted without pains being taken to proscribe types of restriction and discrimination which are extraneous to the purposes of the Fund, the exchange control exceptions will completely undo other efforts to reduce trade barriers.

PURPOSE AND STATEMENT OF PROPOSED CLAUSES

I. To reduce to the strictly unavoidable minimum the discriminatory measures permitted under Article VII of the International Monetary Fund (Scarce Currency Article).

a) To prevent the use of legal formalities as a means of discrimination as between two scarce currency countries:

A COUNTRY APPLYING EXCHANGE RESTRICTIONS UNDER THE SCARCE CURRENCY PROVISION (ARTICLE VII) OF THE INTERNATIONAL MONETARY FUND AGREEMENT SIMULTANEOUSLY TO TWO OR MORE COUNTRIES SHALL APPLY UNIFORM TREATMENT TO APPLICANTS FOR THE CURRENCIES OF THESE COUNTRIES WITH RESPECT TO ALL MATTERS INVOLVED IN LIMITING THE DEMAND FOR THESE CURRENCIES, SUCH AS APPLICATION FOR FOREIGN EXCHANGE, SUBMITTING DOCUMENTS, SECURING IMPORT LICENSE, ETC., WITH THE EXCEPTION ONLY OF THE RELATIVE AMOUNT OF THE ACTUAL ALLOCATION.

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b) To prevent the use of the rationing of a scarce currency by a particular country as a disguised method of protecting certain domestic industries:

WHENEVER A COUNTRY IS AUTHORIZED BY THE INTERNATIONAL MONETARY FUND TO INTRODUCE EXCHANGE RESTRICTIONS WITH RESPECT TO A CURRENCY WHICH HAS BEEN DECLARED BY THE FUND TO BE SCARCE (Articles of Agreement, Art. 7, Sec. 3, paragraph b), THE EXCHANGE CONTROL AUTHORITY OF THE PARTICULAR COUNTRY SHALL ALLOCATE THE SCARCE CURRENCY TO IMPORTERS FROM THE SCARCE CURRENCY COUNTRY IN A DEFINITE RELATION FOR ALL IMPORTERS TO THE AMOUNT OF THE CURRENCY NOW DECLARED SCARCE WHICH WAS PURCHASED BY THE SAME INDIVIDUALS OR FIRMS IN A REPRESENTATIVE BASE PERIOD. THE I.C.P.O. SHALL HAVE THE RIGHT OF REVIEW AS TO THE CHOICE OF THE BASE PERIOD.

IN CASE THE COUNTRY APPLYING EXCHANGE CONTROL UNDER THE SCARCE-CURRENCY PROVISION OF THE INTERNATIONAL MONETARY FUND DESIRES TO LIMIT OR PREVENT THE IMPORTATION OF CERTAIN COMMODITIES FROM THE SCARCE-CURRENCY COUNTRY -- COMMODITIES WHICH THE EXCHANGE-CONTROL COUNTRY CONSIDERS TO BE DISPENSIBLE IMPORTS -- IT MAY WITH THE APPROVAL OF THE I.C.P.O. PUBLISH A LIST OF SUCH COMMODITIES AND MAKE A LOWER ALLOCATION OF EXCHANGE FOR SUCH IMPORTS, PROVIDED THE ALLOCATION IS UNIFORMLY LOWER FOR ALL SUCH DISPENSIBLE IMPORTS AND FOR ALL IMPORTERS OF THESE COMMODITIES AND SERVICES.

N.B. The primary purpose of these two clauses is NOT to secure justice among or for individual importing firms but to prevent the disguised protection of certain industries. Whether the scarce currency is allocated on a uniform basis for all imported commodities as in the first clause, or is allocated on a differential basis as in the second clause, in either event THE SPECIFIC ALLOCATION OF THE SCARCE FOREIGN CURRENCY HAS TO BE MADE TO SPECIFIC IMPORTERS. This gives the appearance to the clauses that they are concerned with relative justice amongst importers. Such is not the case. Concealed protection to certain domestic producers by exchange control (as a substitute for tariffs, etc.) necessarily takes the form of reducing the exchange allocation to specific importers. Rationing imports by commodities cannot be put into effect without also rationing each individual importer involved.

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c) To prevent the Scarce Currency exception from being construed as an exception to the Fund's proscription of bilateral clearing and barter arrangements, whether unilaterally imposed or mutually agreed upon:

RESTRICTIONS IMPOSED UNDER ARTICLE VII OF THE INTERNATIONAL MONETARY AGREEMENT SHALL NOT INCLUDE ANY FORM OF BILATERAL CLEARING AND BARTER PAYMENT ARRANGEMENTS WHETHER UNILATERALLY IMPOSED OR MUTUALLY AGREED UPON.

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d) To forbid the blocking of payments on commercial debts incurred prior to the imposition of exchange control under the Scarce Currency exception; or alternatively, if blocking is permitted, to prevent discrimination in the unblocking of such balances:

PAYMENTS FOR IMPORTS RECEIVED BUT NOT PAID FOR BEFORE THE IMPOSITION OF THE CONTROL OF PAYMENTS PERMITTED BY ARTICLE VII OF THE INTERNATIONAL MONETARY AGREEMENT SHALL NOT BE RESTRICTED.

or alternatively if the blocking of such payments is permitted: -

WITH RESPECT TO BALANCES ACCUMULATED FROM THE PAYMENT OF COMMERCIAL DEBTS INCURRED PRIOR TO THE IMPOSITION OF THE PAYMENT RESTRICTIONS PERMITTED UNDER ARTICLE VII OF THE INTERNATIONAL MONETARY FUND:

1. THE UNBLOCKING OF SUCH BALANCES SHALL INVOLVE NO DISCRIMINATION AS TO AMOUNT OR RATE OF PAYMENT AS AMONG INDIVIDUAL BALANCES OR OWNERS.

2. PAYMENTS FROM SUCH BALANCES SHALL NOT BE MADE CONTINGENT UPON THEIR USE WITHIN THE BLOCKING COUNTRY.

3. IF MORE THAN ONE CURRENCY HAS BEEN DECLARED BY THE FUND TO BE SCARCE, PAYMENTS FROM SUCH BALANCES SHALL BE MADE WITHOUT DISCRIMINATION AS TO AMOUNTS OR FORMALITIES AS AMONGST THE BALANCES OWING TO THE VARIOUS SCARCE CURRENCY COUNTRIES.

II. To prevent the use of permitted control of capital movements for the purpose of controlling commercial transactions.

1. SIGNATORY GOVERNMENTS WILL ACCORD TO THEIR IMPORTERS AND EXPORTERS THE RIGHT OF A PUBLIC HEARING AS TO THE EQUITY OF EXPORT AND IMPORT PRICES ESTABLISHED BY GOVERNMENT AUTHORITY.

2. THE INTERNATIONAL COMMERCIAL POLICY ORGANIZATION MAY FORBID A SIGNATORY GOVERNMENT TO ESTABLISH EXPORT AND IMPORT PRICES IF IN THE JUDGMENT OF THE INTERNATIONAL ORGANIZATION, SUCH PRICES HAVE BEEN USED TO CIRCUMVENT THE PROVISIONS OF THE PRESENT CONVENTION, IN PARTICULAR ARTICLES I, II, AND III.

N.B. The primary purpose of these two clauses is NOT to secure justice as among or for individual importing or exporting firms, but to prevent the permitted regulation of capital movements from being used to circumvent: 1) the prohibition of restriction upon commercial transactions; 2) the prohibition of discrimination amongst other countries; and 3) the prohibition of using the regulation of payments to protect certain (or all) domestic industries.

III. To absorb private windfall profits which would accrue to importers from quantitative limitation of imports permitted by the International Monetary Fund (or elsewhere in the present convention).

GOVERNMENTS APPLYING IMPORT RESTRICTIONS AS PERMITTED BY THE INTERNATIONAL MONETARY FUND OR ELSEWHERE IN THE PRESENT AGREEMENT UNDERTAKE TO PREVENT BY APPROPRIATE DEVICES THE ACCRUAL TO IMPORTERS OF ANY PROFITS WHICH ARISE FROM THE GREATER SCARCITY OF IMPORTED ARTICLES RESULTING FROM THE IMPOSITION OF SUCH IMPORT RESTRICTIONS.

IV. To proscribe the establishment or maintenance of bilateral clearing and barter by signatory governments, and to provide an exception in dealings with states conducting their foreign trade by a state monopoly.

Note: Clauses 1 and 2 represent a proposed rewording of the corresponding clauses in Article II of the Subcommittee's draft text.

1. IF THE GOVERNMENT OF ANY CONTRACTING STATE ESTABLISHES OR MAINTAINS ANY FORM OF CONTROL OF THE MEANS OF INTERNATIONAL PAYMENT, IT SHALL ACCORD UNCONDITIONAL MOST-FAVORED-NATION TREATMENT TO THE COMMERCE OF THE OTHER CONTRACTING STATES WITH RESPECT TO ALL ASPECTS OF SUCH CONTROL OF PAYMENTS.

2. BILATERAL PAYMENT ARRANGEMENTS WHETHER ESTABLISHED OR MAINTAINED BY AGREEMENT OR UNILATERAL ACTION, DESIGNED TO OBVIATE

PAYMENTS IN FREELY CONVERTIBLE FOREIGN EXCHANGE OR TO ESTABLISH OR MAINTAIN A FIXED RATIO BETWEEN DEBITS AND CREDITS ON CURRENT ACCOUNT BETWEEN TWO CONTRACTING STATES OR A CONTRACTING STATE AND A COUNTRY NOT MEMBER TO THIS CONVENTION SHALL BE REGARDED AS NOT COMPATIBLE WITH THE MOST-FAVORED NATION TREATMENT OF THIRD CONTRACTING STATES AS STIPULATED IN THIS ARTICLE.

[3. HOWEVER ESTABLISHMENT OF SUCH RATIOS IN THE TRADE BETWEEN ANY CONTRACTING STATE AND ANY STATE MONOPOLIZING ITS FOREIGN TRADE SHALL NOT BE REGARDED AS AN INFRINGEMENT OF THE STIPULATION OF THE PRECEDING PARAGRAPH.] */

*/ See Explanatory Comments, p.9 below.

EXPLANATORY COMMENTS

pertaining to Part One

I. Reduction of Discrimination under the "Scarce Currency" Article of the International Monetary Fund.

The Report of the Subcommittee on Exchange Discrimination to the Committee on Trade Barriers simply adopts the stipulations of the Final Agreement with respect to scarce currency provision. No attempt is made to provide some safeguards against use of the scarce currency provision a) as a shield behind which disguised discrimination can be indulged in; b) as a measure of disguised protectionism in the sense of favoring particular domestic industries; c) as a means for introducing barter into the field of international commercial transactions; d) finally the problem of balances blocked by the imposition of restrictions under Article VII has not received attention.

a) The Fund agreement prescribes (Article VII, Section 3b) that the limitation on the freedom of exchange operations in the scarce currency "shall not be more restrictive than is necessary to limit the demand for the scarce currency to the supply held by or accruing to the member in question". Equating supply and demand, however, can be achieved by reduced allocation of the scarce currency alone or by the latter in conjunction with various delays and formalities.

It is clear that the scarce currency provision inevitably implies discrimination. As long as there is only one scarce currency

country, it is discriminated against as compared with other countries. But it is quite conceivable, indeed even probable, that if the Canadian dollar for example, is scarce (because basically of British import demands), the American dollar will be also. When there are two or more scarce currency countries, there will be inevitably discrimination as amongst them according to the degree of relative scarcity of individual scarce currencies. Yet while it is necessary to acquiesce in discrimination with respect to amounts of individual scarce currencies as allotted to importers, there is no reason why the most-favored-nation treatment as stipulated in Article II of the draft under consideration should not apply to all formalities attendant upon control of scarce currencies. In other words if simultaneously U.S. dollars and Canadian dollars have been pronounced scarce, a third country may allot to importers from U.S. 50 per cent of their U.S. dollar requirements, and to importers from Canada 75 per cent of their Canadian dollar requirements if this is necessary to equate supply and demand in the respective scarce currencies. This is inherent in the acceptance of scarce currency provision. But there is no reason to allow a third country differential treatment of the scarce currencies involved by discriminating in methods of allocation, by formalities and so on. If there is discrimination it is not only important to minimize its extent but also to prescribe methods of discrimination which are easily disguised and incapable of outside supervision.

Article VII, Section 4 of the Fund Agreement provides for representations regarding inequities of administration of restrictions imposed under this article. Since the Fund Agreement does not speak of non-discriminatory treatment in this respect, the proposed article would, in addition to other purposes, lend increased force to such representations.

b) It seems important, not indeed from the point of view of the Fund, but from the point of view of the I.C.P.O. to erect a bar against a government's use of restrictions under Article VII for purposes of commercial policy, in other words so as to provide increased protection to certain domestic industries. This danger will be minimized if a country should allocate scarce currency to individual importers in a fixed proportion to their requirement of this currency in a certain base period, allowing for differential treatment of broad groups of commodities.

c) The text of the Scarce Currency Article as proposed in the Report absolves a country from the restrictions on bilateralism as imposed in Article II (1) of the draft. It seems, therefore, important that a stipulation should be inserted according to which a country applying restrictions under Article VII of the Fund Agreement should not be allowed to sponsor or impose barter agreements in its trade with the scarce currency country or countries.

It should be noted that the stipulations of Article II (1) of the draft would remain in force for the scarce currency country, but there is nothing either in the Fund Agreement or in the draft to prevent a country from making certain or all imports from the scarce currency country contingent upon equivalent exports to the scarce currency country. In other words all forms of compensation (including bilateral clearing) could be resorted to under restrictions imposed by Article VII of the Fund Agreement. It seems important to prevent such restrictions from developing into a source of bilateralism in international trade.

d) Special problems will be raised by imposition of restrictions under Article VII of the Fund Agreement because almost inevitably it will result in blocked balances arising from imports delivered prior to the imposition of restrictions. Only if the present draft included a provision that commercial debts incurred prior to the restrictions shall be paid on maturity in scarce currency can blocked accounts be avoided. Such a stipulation would probably not be met with the approval of the contracting states. Therefore provisions are necessary to restrict discriminatory treatment of such balances.

II. Prevention of Illicit Use of Capital-Export Control

In the U.S. Treasury's preliminary draft outline of "An International Stabilization Fund of the United and Associated Nations" (July 10, 1943), provision was made in Article VII, Section 4 (p. 20) for cooperation by countries receiving (flight) capital with the Fund in helping a capital-losing country to stem the outflow of funds. The text of the International Monetary Fund as finally adopted at Bretton Woods does not include such cooperation. Consequently countries imposing exchange control to prevent capital losses will be all the more dependent upon their own efforts to prevent undesired capital exports, and amongst the chief weapons is the regulation of export and import prices.

False invoicing of goods by collusion with the foreigner is a favorite device of evasion, since spuriously low import prices and spuriously high export prices effectively transfer purchasing power abroad.

But if it is important for countries to be able to establish standards of fairness for the prices of exports and imports, it is by the same token important to prevent such price control from becoming an instrument of either discrimination amongst other countries or of domestic protection, undoing the work of tariff reduction by agreement.

III. Absorption of Profits Arising from Import Restriction

As a League of Nations memorandum points out,[1/] any quantitative limitation on imports may create windfall profits within the economy which give rise to a vested interest in the perpetuation of the restriction of imports. This is the case whether the import restriction is carried out by exchange control or by quotas. It is also the case whether the quantitative limitation of imports falls under the Transition provisions of the International Monetary Fund (XIV, 2-4) under the Scarce Currency clause (VIII, 3-5), or under the general Balance of Payments Difficulty stipulations of the present agreement (Article III). It is, finally, the case whether the limited import involves a commodity, part of the domestic consumption of which is covered by home production, or not. In the former case both importers and some domestic producers make windfall profits; whereas in the latter case, these gains are limited to the importer. It would appear, however, that the prevention or absorption of producers' profits, ramifying as they might throughout the domestic economy, could not legitimately be expected. Furthermore other parts of the Multilateral Trade Convention are designed to minify protectionist devices.

The devices for avoiding windfall profits to importers are various and the probability is strong that their eligibility will differ so markedly from country to country that a Multilateral Trade Convention should not attempt to prescribe the character of the device to be employed. Thus one country might desire to prevent the windfall by maintaining price maxima. Other countries might find this device distasteful in the postwar

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1/ League of Nations, Confidential Memorandum under date of March, 1944, "Note on Measures to Prevent the Growth of Vested Interests Behind Quantitative Trade Controls During the Postwar Transitional Period of General Shortage".

period, and instead permit the domestic price to rise freely. It would then be incumbent upon the government to absorb the differential between international and domestic prices by the sale of import licenses by competitive bidding, by taxation of windfall gains, etc.

If the device will probably have to be left to the particular state, it becomes all the more important that the Multilateral Trade Convention include a categoric obligation to be assumed by all signatory countries to prevent the retention by importers or producers of windfall profits arising from import limitation. The duty cannot be couched in terms of the government's absorbing the profit, since some governments may desire, by means of domestic price maxima, to prevent the appearance of the profit margin altogether.

IV. Proposed rewording of clauses pertaining to the proscription of bilateralism; provision for an exception in dealings with state trading monopolies

It is felt that Article II in its present form is at the same time too wide and too narrow. It is too narrow because it does not include the so-called payment agreements in the case of which all payments between two countries are made in free foreign exchange, subject however to a fixed ratio between exports and imports. On the other hand Article II in its present form may prove too wide with respect to dealings with a country possessed of an over-all government import monopoly. If the quid-pro-quo of a global import quota for extension of the most-favored-nation treatment to such a country should not find the approval of the Convention, individual countries may well desire to obtain the quid-pro-quo in the form of a fixed ratio between imports and exports to the country in question. Undesirable as such a solution might be, it would be unreasonable to expect the signatory countries to deny themselves the possibility of recourse to bilateral clearing or barter as a defense against a state trading monopoly in default of less restrictive arrangements.

PART TWO: THE PROBLEM OF BLOCKED BALANCES

1. Introductory

The actual settlements or arrangements relative to blocked balances are matters which concern primarily the countries directly involved as creditors and debtors; and it scarcely seems possible that other countries can accept responsibility for these settlements. On the other hand, insofar as the methods of servicing these debts may involve practices incompatible with free and expanding international trade, these methods become matters of concern to outside countries. More specifically, if nothing is done toward funding the debts or providing a regular schedule of freeing certain portions, there is every likelihood of a general recourse to bilateralism and objectionable types of discrimination. Consequently, if it cannot go so far as to intervene in the substantive provisions for the settlement of blocked balances, the Multilateral Commercial Policy Agreement can, and indeed should, indicate the character of a settlement which would be compatible with its general objectives. Depending upon the character of the settlement reached by the countries involved, the Multilateral Commercial Policy Agreement could provide the standards of fairness and non-discrimination suitable to the particular settlement. If the countries involved as creditors and debtors so desired, it might go further and establish instrumentalities or agencies useful in the process of liquidating the debts.

2. General principle: adapting the proscription of discriminatory practices to the extent of funding.

If the entire mass of blocked balances is funded -- at least normal working balances are unfrozen and the balance funded -- there would be no justification for discriminatory practices in any of their manifold forms: bilateral clearing, preferential tariffs, bulk purchasing agreements, multiple exchange rates, etc. This is the ideal and the countries party to the Multilateral Commercial Policy Agreement might well pledge themselves to 1) exert every effort to aid the creditor and debtor nations to obtain this goal; and 2) hold firm to the resolution to prevent all forms of discrimination if the goal is attained.

A fundamental prerequisite is a clear recognition that the problem of blocked balances -- like that of the war debts after 1918 -- is a political problem, and that a solution involves political compromises

which third parties may be in a position to further. On purely economic grounds, the case for making reductions in the principle of the debt in return for funding and a regular schedule of liquidation can be strongly urged by disinterested parties.

The non-political part of the effort to attain to a complete funding of the blocked balances in excess of the unfreezing schedule would be two-fold. In the first place the parties to the Commercial Agreement could, if agreeable to the countries involved, aid in the establishment of an International Blocked Balance Authority, which, under definitely prescribed powers, would issue debentures and carry through the operations necessary to funding. In the second place, the parties to the Commercial Agreement could take measures to aid in the placement of a part of these debentures in their own borders, perhaps with some participation or guarantee by their governments.

To the degree to which funding and scheduling fall short of covering the blocked balances, the parties to the Multilateral Commercial Policy Agreement will be forced to tolerate discriminatory practices against their own exports, with complete tolerance of any and all types of discrimination by the debtor countries as the limit if no funding agreement is reached.

3. Character of discrimination permitted with less than complete funding.

Just because no precise adaptation of tolerated degrees of discrimination can be coupled with specific degrees or amounts of funding, it is impossible to incorporate provisions of the following character into the text of a Multilateral Commercial Policy Agreement. The matter must rest with a general declaration of principle, and the following would serve only as an illustration of the way the principle could be applied.

If the amount of blocked balances covered by funding were small, the Commercial Policy Agreement could provide that balances unfrozen, for example, by England should be made available only for purchases in England, but could prohibit the limitation of purchases to specific English goods and services. If the proportion of balances covered by funding were large, the blocking of unfrozen portions for use within the debtor country could then legitimately be prohibited. Variants from these particular rules will readily suggest themselves, with regard to numbers of discriminatory devices, such as clearing, bulk purchases, tariff preferences, and the like.

Various schemes can be elaborated to bring the proportion of balances unblocked for use only in the debtor country into a reasonable relation to the total balances covered by the funding operation. Thus 1) the length of the amortization period could be made to vary inversely with the proportion of balances funded; 2) within the period of amortization, the annual rate of amortization could be made to increase more slowly or more rapidly according as less or more of the original amount of blocked balances has been funded; 3) the relation between balances unblocked unconditionally and those unblocked for use only in the debtor country could be made to vary so that the latter would be higher or lower relatively to the former according as the proportion funded was lower or higher; 4) finally, the proportion of unconditionally unblocked balances in relation to conditionally blocked balances could be made in all cases to increase throughout the amortization period.

4. Conclusion

No particular significance necessarily attaches to the specific details of any particular schedule. But real significance does inhere in the truth that only to the degree that the blocked balances are definitively funded can the United States and other champions of free and non-discriminatory trade insist upon the adherence of debtor countries to those principles which lay the foundation for a flourishing state of world trade and the attainment of high levels of domestic output and employment. The problem of the blocked balances is the reincarnation of the war debt problem of the First World War. A solution which does not fasten restriction and discrimination upon world trade, assumes an importance for the United Nations comparable to the collective security agreement in establishing and maintaining peaceful intercourse amongst the nations.