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Exchange Control Compared to Quotas as Temporary Equilibrating Devices

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In a general multilateral convention to relax trade barriers, provision may need to be made for import controls to cope with temporary balance-of-payments difficulties, provided insufficient tiding-over credits are available through the Stabilization Fund or other "outside" sources of credit. The question then arises as to whether exchange control or import quotas would be the more eligible device in view of the avowed liberal character of the trade convention. Exchange control in this context would presumably exclude bilateral clearing, multiple exchange rates (at least of an explicit nature) and all such discrimination as does not necessarily inhere in the very necessity of excluding a certain amount of imports by limitation other than that imposed by free market prices. By exchange control we shall therefore mean the authoritarian allocation or rationing of foreign exchange for the payment of imports; and by quotas, the direct quantitative limitation of permitted imports of certain categories. Exchange control in the sense of ad hoc measures to prevent a flight of capital need not be discussed, for though it is a means of bridging over balance-of-payments difficulties, it does not in this particular sense appear as an alternative to quotas, but could be used as a correlative measure.

In some respects exchange control (in the relevant sense of exchange rationing) and quotas stand upon an equal footing; indeed, by and large, their effects are more similar than different. Nothing prevents their being used to achieve exactly the same quantitative limitation on the import of the same goods and services. With either there is nothing to prevent the use of a system of import licenses and the absorption of monopoly gains of importers by the sale (e.g. to the highest bidder) of these licenses or by some system of taxation. And nothing prevents the trade authority in the country involved from limiting imports in either case to the visible supply of available foreign exchange in order to avoid the accumulation of debt on current trade. Finally there appears to be no presumption from past experience that one or the other device lends itself better than the other to administrative application in contrast with the less flexible, quasi-legal form of commercial agreements and treaties.

There are two respects in which exchange control appears to be generically superior to quotas, though I would not stress these advantages very strongly. Exchange allocation can be applied more easily to a group of commodities (e.g. sporting goods) than quotas can be, since it is difficult to invent a physical-quantity common denominator for the articles in such a congeries, while the value common denominator is both natural and unambiguous. And the larger the congeries of goods, the less the import control can be called discriminatory. Secondly, on the score of effective enforcement, exchange allocation would seem to be superior in case the trade authority desired to include services in limitation of imports, for they could easily elude the quantitative quota device.

Two other advantages of exchange control, more important than those just mentioned, are not "generic" but depend upon the institutional fact that neither the exchange allocation nor the quota are apt to be revised at very short intervals so as to maintain imports at exactly the contemplated ("original") level for the period of the emergency.

Imagine a given restriction of imports to be in effect through exchange rationing. If now the prices of imports decline the original exchange ration, being a value total, permits a larger volume of imports; but this is as it should be, since the restriction was introduced to cope with balance-of-payments difficulties, which are now alleviated as imports become cheaper. If the price of imports rises the volume of imports, under a fixed foreign exchange ration, declines; and again this "automatic" effect -- assuming no revision of the aggregate amount of exchange rationed -- is as it should be, since greater stringency now attends the increased balance-of-payments difficulty. But if the restriction of imports were carried through by means of quotas, this automatic and desirable adjustment would be precluded.

A fourth advantage of exchange rationing is that it would permit a larger volume of imports without immediate added difficulty for the balance of payments if foreign sellers, realizing that the trouble is only temporary, would extend more or longer commercial credits. These credits aid in the bridging over, without doubt. Of course if the trouble proved to be more protracted, this advantage would disappear, for the short term credits would eventually fall due. But the risk of only postponing the necessity of payment for certain imports which attends the limitation of purchasing power instead of physical entry, is probably offset by the reflection that exchange rationing prevents (as quotas would not) the speculative purchasing ahead of needs and ahead of actual importation which might develop in the hope of a short period of emergency. On balance therefore from this angle, the advantage lies with exchange control.

The use of either quotas or exchange rationing inevitably involves departures from the categoric proscription of multiple exchange practices and discrimination which both the monetary stabilization plan and the multilateral trade convention contemplate as the normal situation. These departures arise from the facts that on the one hand the international money and trade authorities are not prospectively to be endowed with compulsory powers over member countries' domestic fiscal and monetary powers, and on the other hand exchange rates are -- no doubt advisedly -- not to be permitted to move with absolute freedom. Taking these policies as data, we then address ourselves to the question (as we have here) as to how the departures can be made least objectionable. But there is no denying the basic incompatibility of the devices with the general aim of a free and non-discriminatory system. The apology for using them rests at bottom upon the necessity of temporary stop-gaps in a setting in which the powers of international bodies over domestic economic policies are subject to severe limitations.

The outstanding example of the argument of the preceding paragraph is found in the provision of the International Stabilization Fund that if a currency disposed over by the Fund becomes scarce, the Fund may allocate the currency to member countries according to its own discretion, and permit countries to ration out their allocation according to their own devices. Whatever device this may be (quotas, exchange rationing, etc.), it is clear that the countries must be permitted to "discriminate" against the imports of the scarce currency country, since any uniform reduction of imports from all countries would impose a wholly gratuitous shrinkage upon world trade. The multilateral trade convention could, however, prohibit discrimination against <u>other</u> countries.

If the difficulty pertains primarily to the <u>general position</u> of a particular country, and not just to a scarcity of one currency (for example, dollars), the convention could provide that, if certain commodities are to be singled out (e.g. luxuries) for import limitation, the selection shall not be made in such a way as to be discriminatory against a particular exporter. For example, it ought not to be permitted to restrict Scotch whiskey but not American bourbon. Alternatively it would be possible to make a rule requiring any country resorting to import restriction by exchange control during temporary balance-of-payments difficulties to reduce the exchange allocation <u>by the same percentage</u> for all import items. Such a rule would indeed approach the ideal of no discrimination, though even here some injustice might be involved to a particular export country because of its unusually low position in the country's imports in the base year or years. But the chief objection would be that discriminating against luxuries is a natural or necessary discrimination for a country seeking to economize imports during temporary balance-of-payments difficulties. If the validity of this objection is admitted it would be implicitly upon the basis that some degree of "discrimination" is recognized as "reasonable" (or not intentionally discriminatory) on grounds of social justice <u>within</u> the economy of the import-restricting country.

Much the same reflection is relevant to the matter of import licenses and monopoly gains, whether the licenses are conjoined with exchange rationing or quotas. Having regard to the preservation of a competitive price system and the desirability of state appropriation of monopoly gains, the import-restricting country may well desire to sell exchange to importers in the restricted fields at a price appropriating monopoly profits, or to auction off import licenses, or to tax away monopoly profits in case the licenses are simply granted out-of-hand.

In the first of these three procedures it is quite apparent that concealed multiple exchange rates exist; in the second and third cases the phenomenon is less explicit, but it nevertheless remains a mechanical equivalence. As soon as imports are restricted, the system is in some real sense discriminatory; monopoly gains are inevitable and the only offset -- and this of course offers no solace to foreign exporters -- is that the monopoly windfall can be made to accrue to the government of the importing country.

In conclusion: we have found exchange control preferable to quotas if import limitation is to be carried through for temporary balance of payments stringencies by either of these devices. The case for temporary increases of import tariffs as an alternative to either of these ought to be thoroughly explored before resort to either quotas or exchange control is admitted. In general quotas are generally believed to exercise a somewhat more inflexible limitation on imports than tariffs; and exchange control carries with it the danger that, instead of being directed to nondiscriminatory limitation, it may open the door to all sorts of outright discrimination through multiple exchange rates, country and even personal differential treatment, and the restrictions and distortions of bilateral clearings.