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EXCHANGE CONTROL AND DISCRIMINATION

by

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and a Note on

THE CONCEPT OF DISCRIMINATION

by

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June 10, 1944

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Instruments of Exchange Control

I Government monopoly of dealing in foreign exchange.

II Government disposition over private holdings of foreign exchange and assets.

III Enforcement of an overvalued or undervalued rate of exchange.

IV Multiple exchange rates.

V Government permission to export or to import.

VI Government disposition over the proceeds of exports.

VII Government allocation of exchange to imports.

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Purposes of Exchange Control

A. Primarily with respect to international economic matters

1. To maintain exchange rate against depreciation or appreciation.
2. To attain equilibrium in the balance of payments.
3. To "permit trade to go on" without available foreign exchange.
4. To secure more favorable "terms of trade".
5. To control or force capital movements.
6. To wage economic warfare.

B. Primarily with respect to domestic economic matters

1. To control inflation or deflation.
2. To increase domestic employment
3. To foster industrialization, etc., i.e. "protection".

4. To prepare for or wage war.

5. To provide revenue for the state.

6. To discriminate favorably or unfavorably with respect to certain persons or classes within the domestic economy.

Exchange Control and Discrimination

The purpose of the present analysis is to present in brief compass the character of exchange control with especial reference to the question as to what forms are and are not compatible with a multilateral convention designed to expand international trade, render it more free, and particularly to eliminate discrimination. It is not proposed to attempt a complete description of the economic effects of various types of exchange control, for in general these can be inferred from a sufficiently lucid exposition of character and aims. Exchange control is understood generally to include any or all of the instruments dealt with below; consequently more precise definition is unnecessary, and indeed -- in view of the varieties of meaning both in popular and technical discussions -- probably impossible. But to aid in marking off the field in advance, it may be said that exchange control is not generally taken to include the following: tariffs, quotas, prohibitions and embargoes, subsidies, state trading, and commercial agreements and treaties. It impinges upon these at points but does not include them.

In order to set the whole subject in perspective, we begin with two lists, one giving the main instruments and the other the main purposes of exchange control. The discussion follows the first outline, with continuous cross reference to the second. An international convention undoubtedly aims to eliminate the use of exchange control for certain purposes; but most objective rules and conventions will have to be made on the basis of practices or instruments rather than intent.

I. Government monopoly of dealings in foreign exchange.

This characterizes all exchange control and is essential for any of its manifold purposes. Monopoly may connote only centralization without attempt to enforce a price not compatible with basic equilibrium factors. For a brief period England maintained this mild form of exchange control after the devaluation of the pound in September, 1931 merely to protect the market against violent fluctuations. There is nothing discriminatory or restrictive in such action.

To make the state monopoly effective, however, may require rather far-reaching controls, particularly if the official rates of exchange diverge from what freedom in market dealings would establish. It usually proves necessary to establish a censorship of foreign mail, prohibition of sending out or bringing in the domestic money, of dealing in precious metals, of receiving or making remittances from or to the domestic bank accounts of foreigners, of exporting without guaranty that the proceeds will be surrendered to the exchange authority, of exporting at fictitiously high prices; and finally government access to business records, inspection of the person and baggage of travellers, and more or less severe penalties for all violations. All of these may be involved even if the purpose of exchange control is merely to prevent a flight of capital.

II. Government disposition over private holdings of foreign exchange and assets.

Milder forms of exchange control, particularly those oriented toward meeting temporary balance-of-payments difficulties, may be content with a monopoly over the current flow of exchange from exports. But more drastic controls, particularly if a shortage of foreign exchange bids fair to continue, include the compulsory declaration and tender to the state of individual and business holdings of foreign exchange, currencies, bank accounts, securities, and precious metals. The measure discriminates against the domestic owners of foreign assets.

III. Enforcement of an overvalued or undervalued rate of exchange.

This is almost as ubiquitous a feature of exchange control as the state monopoly in exchange dealing. Indeed it is difficult to find an example of the latter which does not have as its purpose the maintenance of a rate from which the market would tend to diverge. In the overwhelming majority of cases, the control is designed to prevent a depreciation of the country's exchange, though occasionally, as in the operation of the English Equalization Account, foreign exchange was sometimes sold to prevent a speculative appreciation of sterling and a consequent penalty upon British exports.

Inasmuch as the ordinary case involves an official rate which over-values the country's money, nearly all the international and domestic purposes of exchange control involve this phenomenon; and furthermore it is this over-valuation which necessitates all the other devices of exchange control. It is therefore the pivotal characteristic of exchange control save for instances to be remarked upon subsequently.

Most of the exchange control systems in Europe and South America in the 'thirties made their advent as privisional sto-gap devices to prevent a depreciation of the countries' exchange which would have ensued because of the withdrawal or flight of capital from debtor countries. The prevalence of "inflation-mindedness" coupled with the inability of the man on the street to distinguish between devaluation of the foreign exchange value of a currency and domestic inflation, closed the door to setting the balance of payments in equilibrium by a devaluation, say to a level paralleling that of the devalued pound sterling after September, 1931. It was believed that the public would engage in a domestic flight from money into real values and thus, through increasing the velocity of circulation of money, actually bring about price inflation. Thus the original introduction of exchange control had as its motives purposes A1 and B1 in the outline. But purpose A2 -- the attainment of equilibrium in the balance of payments -- ensued shortly, for it was thought that, under cover of the officially stabilized rate, various measures could be taken to make this rate no longer artificially high, the chief measures being deflation of costs and prices and the prosecution of a vigorous program to encourage exports and diminish imports.

However sincere this desire may have been, it is noteworthy that the overvalued exchange rate in itself was a strong force working in the opposite direction from an equilibrated balance of payments. Here we encounter the first important sense in which exchange control is inherently discriminatory, that the overvalued rate discriminates against exports and in favor of imports. From this basic fact follow the exchange control instruments designated by the numbers IV through IX.

Part of the indisposition of countries which had adopted exchange control to affect basic economic changes such as to achieve equilibrium without direct interference in trade is to be explained by the fact that, while an overvalued exchange rate decreases exports (and thereby eventually and inevitably also imports) it does on ordinarily valid assumptions give a favorable turn to the "terms of trade", i.e. the amount of imports purchased by a given amount of exports (Purpose A4). Thus the discrimination which appeared in the preceding paragraph solely as a matter of conflicting domestic interests (exports vs. importers), now appears in a new form, -- a discrimination in favor of the country's nationals as a group as against outsiders.

The maintenance of undervalued rates of exchange such as we have witnessed in neutral countries during the present war is not motivated by a desire to secure less favorable terms of trade, but this is accepted as the price which has to be paid to avoid a currency appreciation which might represent a peril if subsequently, when the war demand falls off it became necessary to devalue. Since the supply of foreign exchange is per se abundant, this variant of Instrument III does not tend as strongly to induce the use of Instruments IV - IX, as in the case of overvaluation. But discrimination of course again appears, in this case causing the nationals of the undervaluing country to lose relatively to outsiders. Within the country the effects are not precisely the reverse of the overvaluation case. There is discrimination against importers relatively to an equilibrium rate (the reverse of the overvaluation case); but there is no discrimination favorable to exporters, because the war causes the foreign demand to be inelastic and hence to be no larger than if the currency were raised in its foreign value.

Undervalued rates in and of themselves tend to produce domestic inflation. But in conjunction with the present war-time exchange controls in neutral countries, this effect is offset - and perhaps even more than offset - by delivering to the exporter only part of the proceeds of his sales in cash, and the balance in government bonds.

Motives or purposes of overvaluation (in the past and for the future the more interesting case) have been found in controlling domestic inflation (see III, paragraph 3 above) and in securing more favorable terms of trade; but we may add now also Purposes B2, 3, and 4, and A6, all of which are per se discriminatory. Overvaluation on ordinary elasticity assumptions penalizes exports and stimulates imports; but since a country cannot continuously (even under exchange control and bilateralism) sell more than it buys, in the long run the overvaluation also reduces imports. This reduction of imports provides protection for home industry and this contributes at least temporarily to the maintenance or increase of domestic production (B2), to fostering home industries (B3), and hence to preparation for war (B4).

IV Multiple Exchange Rates

Under exchange control the central authority may depart in a variety of ways from a uniform purchase and sale rate for a given country's exchange and from "consistency" (such as would be given by trade and arbitraging operations under a free exchange system) as between the rates of various countries.

1. Purchase at a low price, sell at a higher rate (e.g. the "official rate"), or purchase at a series of lower prices and sell at a series of higher prices.

Here the state exploits its monopolistic position against the market generally and transfers to itself some of the windfall gain on the price of foreign exchange which would accrue to importers had they received the "official price" without any reduction. In this procedure the favorable discrimination for importers is reduced.

These remarks appear to be valid no matter to what purpose the government devotes the funds. Cases are numerous where the receipts have been put into the general budget. But it is also very common to earmark these funds to subsidize exports in case of overvaluation. In this event the discrimination against exports through the official exchange rate can be completely eliminated by the subsidy.

A particular instance of IV 1 has been the compulsory sale to the government of repatriated bonds. When exchange control puts a stop to the service of domestic securities held abroad, their prices naturally decline and the corporations would be able to purchase such securities for retirement at a windfall profit. It seems "only right" that the government appropriate this windfall. It is "natural", though by no means necessary that the sums be devoted to subsidizing exports. But again, if the subsidy merely offsets overvaluation, there is no discrimination against foreign exporters, relatively to exporters at home. But the subsidy is ultimately paid by the discriminatory treatment of foreign creditors.

Another and similar case is the monopolization of the purchase and sale of frozen bank and other balances of foreign nationals. Here again the difference between the price which the foreigner may be willing to accept in order to realize cash immediately and the nominal currency value may be appropriated by the state and used to subsidize exports. This is the origin of the various categories of "Sperr" marks. The exchange control, in its moratorium on debt service, discriminates against the foreign creditor (see Purpose A5); but the use of the proceeds does not discriminate against foreign exporters if it does no more than offset the overvalued exchange rate.

2. Export premia, import surcharges (or exchange rates) differentiated according to commodity, or country, or both.

In general this practice represents the most overt type of discrimination. If an absolutely uniform surcharge were added to the official rate at which importers buy bills and if the same amount were added as a premium to the price at which exporters can sell, then it is obvious that not only would the overvaluation of the domestic currency be (partly or wholly, depending upon the magnitude of premia and surcharges) recognized, but discrimination would not be present. Nearly all premia and surcharge systems have, however, been adopted not only as a roundabout device for recognizing devaluation but as a device for monopolistic discrimination against buyers or monopsonistic discrimination against sellers. For discrimination to be possible in either case it is necessary that buyers or sellers be somehow divided into separate markets. Costs of transportation and protective tariffs always separate off markets to a certain extent. But if in addition a system of bilateral clearings exists, the separation into markets can be much more marked, since the device obliges the seller of goods to accept a market where, because there are corresponding sales to his own country, he does not have to wait to receive payment; and for the purchaser of goods, a source of supply for which, because there are corresponding purchases from his own country, he does not have to wait in order to make payment.

Discrimination is possible wherever buyers or sellers are separated into fairly distinct markets; and it is profitable where, in the language of economic theory, the elasticity of supply or of demand differs as between markets -- and this would nearly always be realized because of differences in incomes and tastes as between countries. Thus a country with high incomes or a strong internal demand for the exchange-control country's goods may be forced to pay a high rate of exchange for all its purchases from that country. But it is possible to discriminate not only by country, but also by country and by commodity. Thus the exchange control country may with profit to itself be able to charge different prices to countries A, B, C, etc., on one and the same commodity export, or with profit to itself pay different prices to A, B, C, etc. on one and the same import. But instead of doing so explicitly, it does so covertly by means of different rates of exchange depending upon the partner country and the trade item, leaving only relatively unimportant items to be covered by a uniform rate which attempts no discrimination.

Discriminating rates of these types are used for purpose A4, to secure more favorable "terms of trade"; but they may easily be used, in ways which can easily be imagined, for bestowing favor or meting out punishment either as between outside countries or interests within them, or within the home economy (purposes B 3, 4, 5, and 6). Thus political motives may supersede economic considerations.

V. Government permission to export or import.

If foreign exchange is "scarce" (the price of foreign exchange too low to produce equilibrium), the government may desire to prevent any imports for which foreign exchange will not be available. This measure, often employed in conjunction with exchange rationing for imports (cf. VII below) would, if rigorously adhered to, prevent an exchange control country from running into debt on current account, either in ordinary trade or in the clearing mechanism. It thus serves purpose A5.

The correlative measure for a country with too high rates on foreign countries (such as the neutral countries at present in the war) is the requirement of permission to export. The measure has as its purpose the prevention of accumulating foreign credits (this has been a motive with some of Germany's clearing partners) or the prevention of inflation by restraining the outflow of certain goods.

Authoritarian interference with the free flow of imports or exports is inevitably discriminatory in one sense or another, -- indeed it is simply one side of the shield of which an overvalued or undervalued exchange rate is the other. If the government simply limits the amount of imports (or exports in the case of undervaluation of the country's exchange) without further measures, the consumers of these imports are discriminated against and the importers and domestic producers of these goods enjoy a favorable discrimination against other traders and producers. Price maxima and rationing of the scarce import alter the form of the discrimination against consumers from the price to the quantity dimension but do not eliminate it. Importers windfalls would be eliminated by this device, or by competitive sale of import licences, or by ex post taxation of the windfall gains. The relative merits of these four procedures is not considered further in the present analysis.

VI. Government disposition over the proceeds of exports.

In case of an overvaluation of the country's exchange, the government ordinarily has to take steps to compel the surrender of export proceeds in order to prevent a concealed capital flight (Purpose A5) in the form of leaving these sums abroad on deposit with a bank or with a branch or correspondent of the firm. Occasionally mere pledges are accepted, but a thoroughgoing control may involve posting a bond or depositing guarantees until the export proceeds in foreign exchange are actually delivered.

In the case of an undervaluation of the country's exchange the government's interest in securing the inflow of exchange to itself is largely the control of inflation (Purpose B1). The exporter may receive the value of his surrendered bills of exchange only partly in cash, and partly in bonds or blocked accounts.

Neither of these measures adds anything to the "unavoidable" discrimination if outward or inward movements of capital are to be controlled. They are merely enforcement devices.

VII. Government allocation of exchange to importers

If a country's exchange is overvalued, foreign exchange is scarce and has to be allocated. This may be done with an effort to avoid discrimination, but as has been emphasized before, the consumers of imported commodities as a whole are inevitably discriminated against, since the country's exports and hence eventually its imports must shrink (barring subsidies).

If the government sold bills of exchange or licenses to importers by competitive bidding it would absorb the windfall profit on the activity of importing and provide an automatic allocation of scarce exchange through a price mechanism without resort to rationing.

The most objective method of rationing exchange is the application of a fixed percentage to purchases of exchange in some previous base period to all imports without distinction. Added to the general discrimination just mentioned, there may be a further discrimination against firms with abnormally low import requirements in the base period, against new or growing firms and industries. Furthermore, because of divergent elasticities of demand and supply for different goods, the distribution of imports would, under a free price mechanism operating on an all-around reduction, differ from a uniform percentual reduction for each import.

Another basis, less objective but possibly more just--in the sense of equalitarian--is a discrimination against luxury imports.

Still less objective is the allocation of exchange on the basis of preparation for or the waging of war. Here political considerations supersede the economic profit calculus, (purpose B4).

Closely allied to this, but not necessarily identical, is the use of exchange allocation as an instrument of protection (purpose B3). Sometimes the matter assumes the familiar "infant" industry form.

Just as in the case of multiple exchange rates (cf. IV above), the allocation of exchange can be used as an instrument of economic warfare against outside countries or against political groups in outside countries, or against political, racial, or other groups in domestic affairs.

To prevent an outward capital movement, the exchange authority has to discriminate against demand for this purpose whether from its nationals or foreigners, and whether it arises from interest differencies or otherwise.

VIII. Officially conducted bilateral clearing

Clearing involves the making of payment for exports into, receiving of payment for imports from a domestic account conducted by an agency of the state for trade with a particular country. It is the latter rather than the first feature which causes clearing to differ from ordinary methods of payment which also involve remittances into and from domestic accounts, but they may be to and from any country. Bilateral clearing thus entails that one partner receive payment for its exports to a particular country only in imports from that country, and reciprocally that it derive imports from a particular country, only from its exports to that country. Clearing can, upon ordinary elasticity assumptions, always be made to balance by appropriate adjustment of the bilateral rate of exchange. If the clearing rate of exchange (which may or may not be the same as the "official" rate of the exchange control) does not achieve this balancing, one country is thereby making a tied loan to another in the form of a favorable clearing balance.

One motive for the maintenance of clearing may be precisely this forcing of loans, as in the case of Germany prior to and especially during the present war. Typically however so far as concerns the reason for introducing clearing in the first place, the alleged purpose was rather to provide a mechanism to "permit trade to go on" when the country has exhausted its foreign exchange reserves. But this is a legitimate argument for clearings to a rather limited extent. If the country has a favorable balance, it does not need foreign exchange reserves. If it has an unfavorable balance, the chance that clearings increase its total exports is less then the prospect that clearings reduce its imports, and there is no guarantee that the gap be closed even by both in conjunction. Consequently clearings permit only a smaller volume of trade to "go on", and uncleared balances still remain. Hence to this extent clearings amount to a clandestine device for forcing foreign loans, or a device whereby the exporters of a given country persuade their own government to make the loan through discounting the clearing balances. In either case discrimination of a gratuitous character is involved.

Countries still possessing adequate exchange reserves may impose bilateral clearing upon their trade with a particular country if 1) having a favorable balance in their trade, they wish to try to assure themselves of payment on current account; or if 2) having an unfavorable balance in this trade, they wish, by threatening to suspend current payment, to "thaw out" some old debts owed them by other countries. In either case discrimination favorable to the creditors in a particular country relatively to others is involved. With regard to 1) the consequences may be: a) that exports fall to the level of imports; b) that imports rise to the level of exports; c) that something like the old excess of exports over imports persists, and the export surplus is "paid" in an accumulation of clearing balances. So far as concerns c), this debt may conceivably be paid through a subsequent reversal of the import-export balance, which can usually only be done by outright discrimination in permitted exports and imports. Inasmuch as bilateral clearing limits the choice of exporters as to markets and of importers as to sources, it also means that the actual volume of trade will fall below the level of b), i.e. in the direction of a). Bilateral clearing thus results either in outright discrimination, merely to preserve volume (under c), or in a shrinkage of world trade (which itself proceeds from the inherent discrimination--limiting traders' free choice--which bilateralism necessarily involves).

The "outright discrimination" in clearings involves not only turning exports or imports from one country to another in order to pay off or to be paid accumulated debts, but also the limiting of the list of articles admitted to clearings in the first place in order to achieve as nearly as possible a balancing of exports and imports ab initio.

IX. Officially conducted barter

This usually makes its appearance when bilateral clearing breaks down because of so large a one-sided balance that the creditor refuses to sell further without an immediate quid pro quo. Discrimination is inevitably greater since permission for export or import now involves, beside a decision as to country, also a decision as to particular commodity and as to one particular "deal". The necessity for finding the "double coincidence" entailed by barter reduces the field of free choice and the volume of international trade even below the level of bilateral clearing.

CONCLUSION

In retrospect we can summarize the varieties of discrimination involved in exchange control with especial reference to the types which necessarily inhere in the institution itself, and those which do not. (The discussion is limited to cases of overvaluation, since the opposite case can in general be readily inferred).

1. Discrimination, arising from a prohibition of capital exports, against foreign creditors, or potential home lenders to abroad. Unavoidable except by moderating the prohibitions, e.g. for foreigners.

2. Discrimination against home holders of foreign monetary assets. Avoidable if the country can dispense with mobilizing these exchange reserves.

3. Discrimination arising from high rate of exchange, against home exporters in general and favorable to home importers in general. Export penalty avoidable by subsidies; import windfall profits avoidable by competitive sale of foreign exchange and for import licenses, by price maxima or imports, by taxes on profits.

4. Discrimination, arising from high rate of exchange, against foreign purchasers and foreign sellers (protection). The first discrimination, appearing immediately, makes the home commodities cost more to foreigners; the second, appearing when home imports have fallen to the level of home exports, reduces the foreigners' market. Neither are avoidable as long as the high rate is maintained.

5. Discrimination, through multiple exchange rates, against or favorable to particular countries, particular exports or imports, particular foreign or home groups of persons or individuals. Avoidable through the use of uniform exchange rates. In some cases (e.g. 3 above) discrimination appears as mere by-product of another measure, as for example, a by-product of avoiding a downward rate revision. In the present case, however, it is impossible to imagine the discriminations as other than deliberate. This distinction ought to be borne in mind in comparing the present (5) type of discrimination with those involved under 6 below, which--it can justly be maintained--can greatly resemble the results of multiple exchange rates. There remains however this difference, that whereas multiple exchange rates must deliberately discriminate, rationing does so only in certain cases (q.v.).

6. Discrimination, through exchange allocation for imports against or favorable to particular foreign countries, particular imports, particular foreign or home groups of persons or individuals. Some discrimination unavoidable. Even selling foreign exchange or import licences to the highest bidder does not eliminate the protection to home production following from the limited allocation necessarily attending overvaluation. Rationing relatively little "discriminatory" if made according to (reasonable) objective rule, e.g.: percentage of base year, necessities vs.

luxuries, imports for re-export, etc. Deliberate discrimination, e.g. allocation to party members, racial groups, etc. Avoidable.

7. Discriminations attending bilateral clearing. Avoidable, since bilateral clearing is itself avoidable to achieve exchange-control purposes not themselves deliberate policies of discrimination. If bilateral clearing is adopted, the discrimination against third countries on current trade is unavoidable. By direct discrimination in current trade (but only so), the discrimination of forced loans through clearing balances is avoidable. The use of clearings to force repayment of old loans is avoidable, by omitting such provision.

8. Discriminations attending barter. Avoidable on some basis as clearing. If adopted, discriminations similar to clearings unavoidable, except forced loans which are impossible.

Note on the Concept of Discrimination

by

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Broadly speaking adverse discrimination as applied in the foregoing pages means placing under a disadvantage a category of persons or countries by detracting from the economic benefits which they would enjoy in absence of government interference with the free competitive markets. In this broad sense exchange control is no different with respect to discrimination from any price ceiling.

This means that restrictions may obtain where exchange control is introduced in an attempt to correct discrimination rather than to establish it, e.g. as a weapon against foreign discrimination. If an agricultural country produces and sells a commodity under competitive conditions but imports industrial goods monopolistically marketed, it may see the terms of trade turning against it. Then it may apply exchange control in order to improve her terms of trade. The success of such a policy will depend on the reciprocal elasticities of demand. The effects of exchange control will be the same as described in the preceding pages. However, we could not call them discrimination, because the effect is, in some measure, to correct discrimination introduced by monopolistic domination of the market by foreign exporters. It is therefore only when comparison with a free competitive market is legitimate in terms of actual situations that exchange control is discriminating by definition in all its effects.

The broad concept of discrimination is useful therefore if and when the use of the free competitive market situation is significant in terms of practical policies.

This broad concept of discrimination, however, is not the concept which has been used in foreign commercial policies in what may be called the developed trading system of the 19th century. This is the concept of discrimination in the specific formal or juridical sense of equality of trading opportunity. Since non-discrimination in this sense is still the guiding principle of our foreign policy this concept of discrimination must be considered separately with regard to exchange control. The most favored nation clause was the instrument which on the whole very effectively prevented this type of discrimination.

Absence of discrimination in this juridical sense is not premised upon the absence of government interference. True, the most-favored-nation clause had two effects 1) It assured its beneficiaries of equal treatment in comparison to third countries. 2) It reduced the amount of protection by generalizing reduction to one country. But the second effect took place only if they were such reductions. In other words, non-discrimination in this traditional or formal sense is perfectly compatible with rising and even prohibitive tariffs; it is compatible with outright export and import prohibitions as long as they are applied equally to all countries. This type of non-discrimination is compatible with refusal to allocate exchange for certain commodities, (luxuries) as long as this refusal is applied equally to imports from all countries. It is, in fine, compatible with a system of multiple exchange rates, i.e. with different rates of exchange established for different types of commodities, as long as, say, tourists from all countries obtain the same lower rate of exchange or as long as importors of luxuries from all countries receive a lower rate of exchange. For this type of "discrimination" is analogous to the structure of a country's tariff on imports or system of export subsidies. The multiple rates of exchange are not essentially different from the "multiple" rates of a tariff.

However, logical or juridical compatibility is one thing, practical economic significance is another. Most-favored-nation clause played its useful role not because it was compatible with a general prohibition against foreign trade but because in an economic environment where foreign trade was primarily regulated by tariffs, and these tariffs were relatively low, not only a large and growing amount of foreign trade was possible, but the formal equality of the most-favored-nation clause fitted the fact that the determination of the volume of trade was left to the objective mechanism of the market. As long as government intervention did not extend to the determination of the volume of trade the most-favored-nation clause was felt to be a sufficient guaranty of trading equality, or, more precisely, the formal equality of treatment was regarded as sufficient.

The appearance of exchange control and bilateral clearings apart from being "discriminatory" in the broader sense of the word presents a special problem because they are discriminating in a quite special sense: exchange control in conditions of an overvaluation involves shortage of foreign exchange. In absence of exchange control this shortage normally is overcome either by an outflow of gold, by a change in relative prices and incomes, or by a reduction of the rate of exchange. The existence of a permanent shortage raises the problem of allocation of foreign exchange among imports from individual countries and this introduces an element of arbitrary determination of the total value of trade which is alien to the nature of the most-favored-nation clause. Therefore discrimination handled in the preceding pages under 5,* 6, 7, and 8 differs from the preceding types of discrimination in that it is not only discrimination in the broad sense of the word, but discrimination from the point of view of the formal equality of the most-favored nation clause. In other words - the problem is how to handle exchange control so as to make it compatible with the formal equality of treatment as required by the clause.

The answer then is, as already stated, that any type of Government allocation of exchange among countries is alien to the nature of the clause. The makeshift device of base period never was satisfactory and will be fully fictitious after interruption produced by the war. The

* So far as concerns discrimination against countries.

only satisfactory device is sale of exchange to the highest bidder and only to the extent that this is possible can exchange control be made compatible with the most-favored-nation clause.

In the case of discriminations listed under 7 and 8 the compatibility with the most-favored-nation clause could be preserved only to the extent that a country undertakes to offer a clearing agreement it has concluded with one country to all other countries. Needless to say this is almost meaningless. The functioning of the clearing requires enforcement of a certain ratio between exports and imports and whether this is achieved by temporary export or import prohibitions, or changes in exchange rates or price changes, these devices cannot be generalized and as such are incompatible with the formal equality of the most-favored-nation treatment.