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Notes on the Problem of Discrimination in
the British Import Program

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As one way out of their present difficulties, the British are understood to be seeking a relaxation of the Anglo-American Financial Agreement which would permit them to discriminate between "hard currency" and "soft currency" areas by diverting purchases from the former to the latter or by restricting purchases from the former while maintaining them from the latter. In his speech in the House of Commons, Mr. Attlee stated with respect to this matter:

> "[Where] 'soft currency' sources are, all things considered, more favorable from the commercial point of view, the question of discrimination under Article 9 of the loan agreement will not arise. Where, however, such purchases cannot be justified under the terms of the loan agreement, we shall be exploring the situation immediately with the United States Government to see what steps can be taken to enable us to obtain supplies from 'soft currency' areas."

Extent to which British can benefit from discrimination

In most discussions of this subject, including Mr. Attlee's, the advantages which the British might derive from discrimination in their import trade is obscured by the use of the terms "hard currency" and "soft currency" areas. Only if the United Kingdom has a surplus in its current account relations with another country, and is accepting payment in the other country's currency, is it significant whether that currency is "hard" or "soft"--i.e. whether it is convertible or transferable to third countries. If it is not, the British are forced to finance the other country's deficit by accumulating unusable balances of its currency. But where the United Kingdom has a deficit in its current account relations with another country (obviously the more characteristic case), the hardness or softness of that other country's currency is quite irrelevant. In this case, the important question is whether the other country is prepared to finance the United Kingdom's deficit (a) by repaying debt to the U.K. (including repatriation of assets), or (b) by lending to the U.K. (through accumulating sterling balances in London or otherwise). If it is not, the deficit is almost certain to become reflected in a drain on the U.K.'s gold and dollar reserves so long as sterling is "convertible".1/

1/ There may be a few unlikely and unimportant exceptions.

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Of course, to the extent that the volume of British purchases in a given country determines the volume of that country's purchases in the United Kingdom, the imports create a market for exports and become "self-liquidating". But even if this were wholly true of British trade with a given country, discrimination in favor of that country would bring no net gain to the British unless the goods with which they paid could not otherwise have been exported.[1]

In general, therefore, the British cannot improve their dollar position by discriminating against imports which must be paid for in dollars unless the purchases elsewhere (a) diminish the extent to which the British have to finance other countries' deficits, (b) are financed by loans or capital repayments from other countries, or (c) induce other countries to purchase British goods which could not otherwise have been exported.

Clearly (a) and (c) are very exceptional cases, and the British can scarcely be expecting any substantial relief through reliance upon such circumstances. Case (b) must be the main hope. Furthermore, since the British are understandably reluctant to liquidate their foreign investments (except non- or low-yielding assets such as their holdings of clearing balances, e.g. in Danish crowns), they must be relying principally on the expectation that they can again obtain loans from their trading partners, especially through the renewed accumulation of sterling balances in London. While such loans may be extracted from Empire dependencies (whose policies are dictated from London in greater or lesser degree), and may be forthcoming on a voluntary basis from the Dominions (but not India or Egypt), it would seem that no substantial aid is likely to be provided by other countries so long as their current sterling earnings in the United Kingdom are freely transferable.

<u>It is therefore concluded that discrimination against imports from the United States will be of only limited usefulness to the British unless they likewise obtain relaxation of their "convertibility" obligations under the Financial Agreement</u>. Even then, the results may be disappointing--recall Lord Keyne's scathing indictment of the thesis that Britain could continue to extract blocked sterling loans from its trading partners:

> "The way to destroy the sterling area is to prey on it and to try to live on it. . . . . . [This would mean trying] to build up a separate economic bloc consisting of countries to which we already owe more than we can pay on the basis of their agreeing to lend us money they have not got and buy only from us and one another goods we are unable to supply."

1/ Again there may be a few unlikely and unimportant exceptions; and some net gain might possibly be realized price-wise.

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Extent to which British may be permitted to discriminate against U.S. imports[1] without prior Congressional consent

This question may be considered under three headings:

(a) Latitude in definition of discrimination;

(b) Permissive exceptions specifically stated in Section 9; and

(c) Possibility of British conforming to letter of Section 9 while nullifying its effects through their administration of exchange control.

(a) Discrimination has already been defined for the purposes of the Financial Agreement as excluding preferential treatment for imports from the Empire dependencies.

Aside from this exception, the concept of "discrimination" is a rather elastic one. The British may be expected to press for a very broad definition of "commercial considerations" (see underlined passage in quotation from Mr. Attlee on page 1). It is clear that these do not comprise merely price-cum-quality considerations. The British may seek to justify arrangements which would appear to constitute discrimination if measured by this test alone, on the ground that other supplying countries are prepared to:

1. Give long-term assurances as to availability and price of supplies (characteristic of bulk-purchase contracts); or

2. Engage in reciprocal purchases from the U.K.; or

3. Finance the British purchases by lending or repaying debt to the United Kingdom.

The first argument may be admissible, but obviously acceptance of the second and third would amount to almost complete emasculation of the concept of discrimination. This could hardly be countenanced, if only because it would likewise destroy the usefulness of the anti-discrimination clauses in the Charter of the International Trade Organization.

The British may also appear to historical trade relationships to justify departure from strict price-cum-quality criteria. It may be alleged that no discrimination exists in British purchases of a given commodity so long as

1/ Note that the British are not bound under the Financial Agreement not to discriminate against imports from other countries demanding payment in dollars.

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the United States maintains its "prewar" share of British imports of that commodity. Support for this argument may be found in some of the provisions of the present I.T.O. charter. But uniform application of this principle might require the British to increase their purchases of some American products. The question therefore arises of whether they could be allowed to invoke either "historical share" or "commercial considerations", depending upon their convenience and advantage.

(b) The permissive exceptions in clauses (a), (b), and (c) of Section 9 require little comment.

Clause (a) recognizes a special case in which the British are to be allowed to discriminate in order to collect a debt. The fact that such a specific exception was made supports the argument that in general it would be discriminatory within the meaning of the Agreement for the British to grant preferential treatment to imports from third countries simply because they were financed by the repayment of debt (cf. argument 3 under (a) above).

Clause (b), as has been shown by the report of the National Advisory Council working party, is not capable of very broad construction. It envisages discrimination by the British for the purpose of assisting third countries, and can scarcely be invoked merely to alleviate the British situation.

Clause (c) is self-explanatory, but its presence in the Agreement emphasizes the British interest in expediting a declaration by the Fund that the dollar is a scarce currency. Under the present Articles of Agreement, such a declaration remains a long way off. But it would be brought nearer if member countries were granted larger and freer access to the Fund's resources. Or Article VII could be amended to permit such a declaration in conditions of "world dollar shortage", whether or not dollars had become "scarce" in the Fund.

(c) It is possible that the British may make a radical suggestion for complying with the letter of Section 9 while evading it completely through exchange control measures to be introduced with the consent of the United States under Section 8(ii).

The Financial Agreement was written in terms of the existing machinery of British trade and exchange controls, under which exchange is allocated automatically for licensed imports. But this system is not sacrosanct. Suppose that the British continued administering their "quantitative import restrictions" pursuant to Section 9 in fully non-discriminatory fashion (however that might be defined), but that exchange allocations were handled independently. There is no requirement in the Agreement that exchange allocations be made on a non-discriminatory basis. In Section 8(i), the British Government simply agreed as from July 15, 1946, "not /to/ apply exchange controls in such a manner as to restrict payments or transfers in respect of products of the U.S. permitted to be imported into the U.K. or other current transactions between the two countries."

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Obviously the words "permitted to be imported into the U.K." were intended to mean "for which an import license into the U.K. has been issued". But the language is more general and open to the construction that permission could be withheld through denial of exchange--the clause would then mean only that any sterling which was allowed to be paid to American residents for current transactions would be freely convertible. It is interesting to note that in practice this is all it has meant with respect to current service transactions between the U.S. and the U.K. The volume of American services purchased by British residents (e.g. services to British tourists) has been regulated entirely through exchange allocations.

With a minor twist of interpretation, therefore, the British might claim freedom under Section 8(i) to discriminate against U.S. imports through administration of their exchange control. However, they would still be subject to the general obligation under Section 8(ii) "to impose no restrictions on payments and transfers for current transactions" after July 15, 1947, unless a later date is agreed upon by the parties (there are some specific exceptions not relevant to this discussion). Hence such a plan as that outlined above would require the consent of the U.S. Government, but a consent which could be given without prior consultation with Congress.[1]

J. Burke Knapp,
Board of Governors of the
Federal Reserve System,
August 11, 1947.

[1] Incidentally, the whole British practice of using exchange allocations to regulate British consumption of foreign services is clearly a violation of Section 8(ii) in the absence of specific agreement with the United States regarding its continuance. This troublesome point was raised in some of the discussions during the British loan negotiations but was never dealt with effectively.

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