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The Principle of Nondiscrimination: 8 pages
Recent Developments in the Light of Convertibility and the Present State of the Balance of Payments

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The Principle of Nondiscrimination: Recent Developments in the Light of Convertibility and the Present State of the Balance of Payments

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Summary

(1) The European convertibility move of December 1958 calls attention to Europe's present economic and financial strength. Each country's entire surplus or deficit in international payments is now to be handled in the same manner as its surplus or deficit with the United States.

(2) Important changes in the world balance of payments over the past few years lie behind the convertibility move. Europe is competing effectively in world markets, and the United States is providing the world with a large flow of capital. Any idea of a "dollar gap" has become meaningless for the foreseeable future.

(3) Several countries in various parts of the world have recently eliminated or reduced dollar discrimination. The announcement of external convertibility by the European countries formalizes and dramatizes for countries outside Europe the end of the "dollar shortage."

(4) Within Europe, French protectionism is a major obstacle to the logical corollary of convertibility and the present balance-of-payments situation, namely, elimination of discriminatory direct controls on imports. Common Market ideology on this issue actually calls for increased rather than decreased discrimination. Acceptance of this view would seriously weaken the position of the United States in the whole field of trade policy, at a time when our own balance of payments calls for increased efforts to get foreign trade barriers reduced.

1. The convertibility move of December 1958

The formal establishment of nonresident convertibility by 14 European countries is, from the point of view of those countries, only another step in a long series of moves away from dependence on direct controls internally and externally, and toward reliance on the play of market forces to stimulate and direct economic activity, as well as toward reliance on flexible monetary and fiscal policies to prevent inflation or deflation and to maintain equilibrium in external payments. This long-sustained movement has been intimately related, on the one hand as effect and on the other hand as contributory cause, to Europe's postwar recovery and to Europe's increasing faith in its own economic future.

For the countries concerned, the recent announcements of external convertibility serve a major purpose of reiterating their adherence to the broad aim of providing greater freedom in international trade and payments. At the same time, they call the attention of the world to Europe's present economic and financial strength. None of the major countries could afford to disassociate themselves from this move, France least of all. Though France has not been in the forefront of the movement toward multilateralism, it was able to participate because its financial policies over the past year had already begun to yield useful results in internal stability and external balance, and because the devaluation of the franc, which had become a prerequisite for convertibility, was needed to round out the stabilization program.

An important consequence of the convertibility move was the termination of the European Payments Union. Arrangements worked out four years earlier to replace EPU by the European Monetary Agreement were brought into effect. The significant point of this change was to abolish automatic credit financing of 25 per cent of the monthly balances in intra-European payments. Surpluses and deficits of individual countries within Europe are now to be covered in precisely the same ways as these countries' payments surpluses and deficits with the United States: by private capital movements, by ad hoc extensions of credit by international agencies, and by voluntary official gold and foreign exchange transactions, including voluntary changes in one central bank's holdings of another's currency. This change reflects a general recognition that each of the major European countries should be able to avoid serious external disequilibrium and that, in any case, each country is really concerned with its external balance over-all rather than bilaterally with particular countries or groups of countries such as the OEEC membership.

2. The balance of payments

The decision to establish nonresident convertibility in December 1958 was influenced by growing appreciation of the fact that the balance of payments between Europe, the United States, and other countries is now such that any idea of a "dollar gap" has become completely meaningless. Europe has regained an ability to compete effectively in world markets. The United States is providing a large outflow of capital to other areas, much exceeding the U. S. current account surplus.

In 1955, 1956, and 1957, the view that Europe's "dollar-gap" problem was insuperable could still find adherents. Although foreign gold and dollar holdings were growing steadily until the time of the Suez crisis, attention was fastened on the very rapid increase in foreign purchases of U. S. exports of goods and services, from $18 billion in 1954 to a rate of $27 billion in the first half of 1957. From the time of the Suez crisis until speculation against the pound sterling and some other currencies was halted in September 1957, there was much talk of an "international liquidity crisis."

At the moment when confidence in sterling was at its lowest ebb, the world boom of 1955-57 was already beginning to taper off. Soon it could be seen that U. S. exports had gone much above a sustainable level in the first half of 1957. On the other hand, other elements in the balance of payments were continuing to look very favorable for the rest of the world.

The great bulge in U. S. exports in 1956 and early 1957 reflected not only emergency buying of petroleum by Europe from the United States but also, and more importantly, efforts abroad (in Europe, and also in Japan and other countries outside Europe) to build up inventories of such raw and intermediate materials as cotton, steel scrap, coal, and rolled steel. With the ending of the world boom, there developed world-wide recessions in steel and textile industries, a general decline in world prices of basic commodities, and a sharp drop in U. S. merchandise exports during the latter part of 1957 and the first months of 1958.

In 1958, after abnormal demands had dried up, total U. S. exports of goods and services were $23 billion, much smaller than in the first half of 1957. The decline was concentrated in exports of goods, which were about $16 billion in 1958, as compared with a seasonally adjusted rate of $20.5 billion in the first half of 1957. There remained an export gain of about one-fifth over 1954-55 levels, an important part of which was in exports of machinery and equipment. While this increase in exports was about in line with other industrial countries' export gains over the same period, during 1958 U. S. exporters of finished products were finding foreign competition much stiffer than in earlier postwar years.

Among the other elements in the balance of payments which have continued to look favorable for the rest of the world, U. S. imports and the outflow of U. S. private and Governmental investments and loans both held at high levels during 1958. Imports began to resume their growth last autumn, and the capital outflow in 1959 may be nearly as large as in 1958.

It was the steady growth of imports from 1954 through 1957 and the very rapid increase in the outflow of U. S. capital (which reached its peak in the eighteen months from the beginning of 1957 through the first half of 1958) that allowed the rest of the world to gain dollars and gold from the United States on balance until the latter part of 1956, and that kept the drain on foreign reserves to a minimum (with the help of the IMF) during the subsequent period of worries about international liquidity. Some of the relevant figures are shown in the table on page 4.

During 1958, the rest of the world acquired $2.3 billion of gold from the United States and added $1 billion to dollar balances.

These large net transfers of gold and dollars, much larger than at any time since just after the outbreak of the Korean war, can be regarded as the result of the greatly increased capital outflow, which is not being matched by correspondingly increased net exports of goods and services. Among the important components of the increase in capital outflow have been an increase in U. S. purchases of foreign and World Bank securities, an increase in the outflow of bank loans, an increase in U. S. Government financing of agricultural exports through acquisition of foreign currencies, and an increase in Export-Import Bank lending. The outflow of direct investment in U. S. companies' affiliates abroad was also larger in 1958 than in 1954-55, though much smaller than it had become in 1956-57.

U. S. Balance of Payments

(In billions of dollars)

	1954-1955 average	1956	1956-IV through 1957-III	1958 (est.)
Payments from U. S.	20.9	25.7	27.2	26.8
Imports of goods and services	17.0	19.8	20.5	20.6
U. S. capital - private	1.4	3.0	3.7	2.8
- Government	0.1	0.6	0.7	1.1
Grants, remittances, etc. 1/	2.4	2.3	2.4	2.3
Exports by U. S. 1/	19.0	23.5	26.4	23.1
Goods	13.5	17.3	19.5	16.2
Services	5.4	6.2	6.9	6.9
Net transfers of gold and dollars from U. S. 2/	1.3	1.0	-1.0	3.4
Gold	0.2	-0.3	-0.7	2.3
Dollars	1.1	1.3	-0.2	1.1
Other items:				
Foreign long-term investment in U. S.	0.3	0.5	0.4	0.0
Errors and omissions	0.3	0.7	1.3	0.3

1/ Excluding military transfers of goods and services under grants.
2/ Including additions to dollar holdings of international institutions less U. S. gold purchases from them, of 0.1, -0.6, -1.3, and 0.2.

In 1958, Europe added greatly to its gold and dollar holdings, through payments surpluses not only with the United States but also with other areas. Despite a considerable decline in the value of its purchases from those other areas, Europe was able to maintain its exports to them at least as well as the United States did.

For the United States, the problem of achieving better balance in international payments has now become primarily a problem of bringing U. S. exports up more nearly into line with outpayments from the United States. The current and prospective level of outpayments can be regarded as adequate for the world's needs, and is clearly high enough to deprive other countries of the main justification they claimed in earlier years for maintaining discriminatory direct restrictions on their purchases from the United States.

3. Recent and prospective removals of discrimination outside Europe

In some degree -- in what degree it would be hard to say -- discrimination in systems of quantitative restriction abroad creates difficulties for U. S. exports, over and above those of a strictly competitive sort. With the change in the world balance of payments, the continuance of such discrimination against purchases from the United States has become completely indefensible in principle. The United States now has a stronger interest than ever in the removal of such discrimination.

For the importing countries, too, removal of discriminatory restrictions will generally be in their own best interest. Where such restrictions are not maintained for protectionist reasons (or what comes to the same thing, for their use in supporting bilateral trade arrangements for the benefit of the country's exporters), the only problem in removing them is that of short-run impacts on the balance of payments. If, for balance-of-payments reasons, quantitative restrictions on the imports of a particular commodity are considered necessary, global quota arrangements can always be worked out, given time, to have the same net effect on the balance of payments as the existing discriminatory quotas. Frequently, no balance-of-payments justification for the direct control of imports exists.

In all such cases the maintenance of restrictions on imports from the United States may be due purely to a cultural lag, to a habit of thinking that dollars ought to be used more carefully and cautiously than other foreign exchange resources.

For most countries it is now as easy to earn or borrow dollars, directly from the United States or from others, as to earn or borrow other currencies. The availability of free markets for transferable sterling has for a number of years already made it possible for traders to buy dollars at a moderate premium against other currencies. In countries that keep their official reserves in sterling, convertibility of those reserves into dollars for current expenditure has for a long time been virtually unrestricted by Britain.

Thus it is not surprising that various countries have been putting some or all of their imports from the United States under global quotas, or relieving them from quota restriction of any kind. Measures of this sort have been recently taken by Malaya and Ceylon. Argentina, in abolishing all quantitative import restrictions as a step in its new stabilization program, has made no distinction between dollar imports and other imports.

The announcement of external convertibility by the European countries formalizes and dramatizes for countries outside Europe the end of the European "dollar shortage." Any country that has European currencies can obtain dollars in exchange. No country can be short of dollars unless it is short of all European and North American currencies.

The first case of action to reduce discrimination taken outside Europe in direct consequence of the European announcements has been Japan's abolition of distinction between the dollar area and other areas in its administration of exchange controls over imports with the exception of fourteen designated commodities. The significance of this action is considerably diminished, however, by the exceptions that were made. It is in the interests of the United States that further reduction of discrimination should be undertaken by Japan and other countries.

4. Nondiscrimination in Europe.

For the European countries that participated in the convertibility move, just as for countries outside Europe, there is no basis in logic for continuing discrimination against U. S. goods. It is evident, however, that the European countries, unlike some countries outside Europe, have been increasingly aware of the developments, within their own economies and in the balance of payments, that have made convertibility and nondiscrimination possible. Many of them have already gone far toward removing all discrimination in their import controls maintained for balance-of-payments reasons. As long ago as 1953 or 1954, Greece, the Benelux countries, Sweden, Germany, and Britain took big steps in this direction, and in 1955 and 1956 there were further important moves by several countries. Immediately following the 1958 convertibility announcements, Norway virtually completed the liberalization of its dollar trade. Switzerland, throughout the postwar period, has had no import controls maintained for balance-of-payments reasons.

By 1958, some European countries had gone further than others in this direction. Last December the others must have had to weigh the short-run impact risks of completing the removal of discrimination and of establishing external convertibility. Probably it would have been too much to have expected Britain to undertake both actions simultaneously. The situation at the moment was auspicious in a number of respects for the convertibility move, and the successful accomplishment of that step will now facilitate the removal of discrimination throughout the world. At the Montreal Conference last September, the United Kingdom committed itself to taking an early opportunity to remove most of the remaining discrimination in its own controls.

Among the six members of the Common Market, the old question of discrimination in import controls as between the dollar area and the OEEC membership (with their related currency areas) has recently been given a new twist. Some people now assert that Common Market members must discriminate in direct controls, as well as in tariffs, between the dollar area and all nonmembers of the Common Market on the one hand, and their partners in the Common Market on the other hand. Obviously, discrimination of this new kind can no more be based on balance-of-payments considerations than can the old kind of discrimination against the United States. Is there any other basis for such discrimination that the United States ought to recognize? In considering this question, we should not lose sight of the vital role the General Agreement on Tariffs and Trade can play in protecting our export interests.

The General Agreement on Tariffs and Trade treats quantitative restrictions on trade, whether discriminatory or not, as essentially temporary, and (in Articles XII and XIV and elsewhere) narrowly defines the conditions under which they can exist. The signatories of the Rome Treaty are all contracting parties of the GATT, and as such are committed to the principle that direct controls on international trade are in general undesirable. The fact that the Treaty of Rome contains specific provisions for removing quantitative restrictions among the Six, but says nothing about avoidance of discrimination against nonmembers, can be explained only by the habituation of governments, during the long period of transition after the war, to thinking that quantitative restrictions had become as permanent a feature of the economic landscape as tariffs themselves. At the time the Treaty was written, in 1955 and 1956, the climate of opinion in Europe and in many quarters in the United States was unduly pessimistic as to the outlook for European balance-of-payments equilibrium and convertibility.

Article XXIV of the General Agreement on Tariffs and Trade, relating to customs unions and free trade areas and to "an interim agreement leading to the formation of such a union or area," which is what the Treaty of Rome is, does not release signatories from any of their responsibilities for getting rid of discriminatory and other quantitative restrictions. It does permit a country entering such an agreement to postpone elimination of restrictions against its partners within the agreement, if those restrictions are permitted under other Articles of GATT to safeguard the balance of payments or for other reasons. This is a far cry from giving countries blanket permission to retain direct controls, and, in effect, to apply such controls in a manner even more discriminatory than before, when they enter the Common Market. There is thus a real question, now that Europe's "dollar shortage" has gone, whether execution of the provisions of the Treaty of Rome relating to quantitative restrictions can any longer be regarded as consistent with the spirit of GATT, unless it is accompanied simultaneously by liberalization of controls on imports from outside the Common Market.

If, despite the great changes that have now become evident in the balance of payments, Common Market discrimination in direct controls should become an actuality, protectionist influences would gain an important victory, transitory though it might prove. Justification for discrimination in favor of Common Market members cannot be found, under present conditions, in the terms that have hitherto governed the evaluation by GATT or the IMF of discriminatory trade and exchange controls. Acceptance by the United States of short-sighted political justifications for quasi-permanent discriminatory restrictions would weaken our position in the whole field of trade policy.

We do not yet know what the outcome will be. Are the United States and the Six losing sight of the vital GATT principle that direct controls or international trade are in general undesirable and that discriminatory direct controls are the most undesirable of all? If so, there is a grave danger that protectionism in France and other Common Market countries will be given undue influence, and the position of GATT undermined, at a time when the state of the world balance of payments calls for increased efforts to reduce restrictions on international trade. It is to be hoped that as France regains stability and competitive power, less protectionist counsels will prevail in that country, though perhaps only under pressure from France's friends inside and outside the Common Market.