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DOLLAR SHORTAGE AND DISCRIMINATION 1/

Albert O. Hirschman

In an interesting series of articles on "The World and the Dollar" the London Economist came recently once more to the conclusion that discrimination against American goods is an essential tool of commercial policy if Europe and the world are to achieve recovery and economic independence.2/ The "admirable doctrine" of nondiscrimination must be shelved, according to the author of the series, as long as the world does not have as many dollars as it would like to spend.

This thesis is in the process of becoming widely accepted. The United States made substantial concessions to it in agreeing to the "scarce currency" clause of the Bretton Woods Agreements on the International Monetary Fund and to Article 23 ("Exceptions to the Rule of Nondiscrimination") of the ITO Charter. The advocation of closer European union by the United States has been interpreted as the final admission that the "admirable doctrine" could not be maintained, let alone applied, in the present situation.

1/ For a previous note on the dollar shortage, see this Review, August 24, 1948.
2/ The Economist, June 26, 1948, pp. 1051-1052; July 3, 1948, pp. 4-5; July 10, 1948, pp. 44-46.

The examples cited to support the case for discrimination appear quite convincing at first sight. Why should Britain restrict the purchase of books from Australia and of tobacco from Kenya simply because the dollar shortage forces it to limit book and tobacco imports from the United States?1/ Why should Canada ban chocolate imports from France only because the dollar shortage forces it to prohibit imports of American candy bars?2/ Why, in other words, should the restrictive effects of the dollar shortage be allowed to affect, and possibly paralyze, trade among the nondollar countries?

In reviewing this argument we shall not discuss here the general case for or against discrimination. We shall rather meet the argument on its own ground, i.e., we shall examine only how likely it is that discrimination is an effective device in dealing with the dollar shortage. It is the contention of this note that a consistent policy of discrimination is likely to impede structural changes in trade patterns which are necessary for the overcoming of the present condition of imbalance in international economic relations. This may be made clear in the following manner:

(1) Suppose that in the second example cited above Switzerland (a more likely source of chocolate imports for Canada) is substituted for France. Then, it will be seen immediately, the argument that it would be senseless for Canada to ban chocolate imports from Switzerland along with those from the United States does not hold any longer. For any export surplus that Canada is able to secure with Switzerland through a reduction in imports would be readily convertible into dollars and would pro tanto reduce Canada's dollar deficit.

(2) Let us now return to the original example with France as the third country. A Canadian export surplus with France is not convertible into dollars and does not therefore make any immediate contribution to the easing of Canada's dollar position. But surely Canada will not indefinitely accumulate French francs. It will either be successful in pressing the French for imports more essential than chocolate, or it will have to make a determined attempt to redirect part of its exports from France to the United States. In both cases, its dollar position is likely to be improved.

(3) But, it will be argued, Canada is not likely to achieve an export surplus at all as the result of its nondiscriminatory import cuts because France by pursuing the same policy will have reduced its purchases of, say, books from Canada along with those from the United States. The consequence of dollar shortage plus nondiscrimination is then the stifling of trade among France and Canada. This may well be true, but it may be asked whether the consequence of this particular reduction in mutual trade would not be beneficial in the longer run. For the reduction in intertrade between France and Canada makes export surpluses available in both countries which may be redirected to the Western Hemisphere; and in case such redirection is not possible the resources released by the reduction in intertrade could be devoted to the production of goods which would find an outlet in the dollar area or which might replace goods previously imported from that area.

1/ Thomas Balogh, "The Problem of the British Balance of Payments", Bulletin of the Oxford Institute of Statistics, Vol. IX (July 1947), p. 222.

2/ The Economist, July 10, 1948, p. 45.

It is generally recognized that the solution of the "dollar problem" will require far-reaching readjustments of trade patterns and, in particular, an expansion of Europe's sales and a reduction of its purchases in the Western Hemisphere. But it is one thing to state this necessity and another to provide sufficient incentives and penalties to bring the readjustment about. If the whole burden of the readjustment is thrown on the bilateral relationships between the United States and the dollar-poor countries, while all other trade relationships are carefully insulated from the effect of the dollar shortage, the elasticity of the trading system and its capacity for readjustment are greatly reduced. It is a fallacy to assume that because currencies are largely inconvertible, no multilateral adjustment of a given bilateral trade relationship in disequilibrium is possible at all. This adjustment is merely more laborious than under conditions of currency convertibility since it requires the reshuffling of exports and of resources. Especially under conditions of full employment, it is hard to see how equilibrium can at all be reestablished without such reshuffling.

The preceding argument may be considered from a somewhat different angle: Suppose that there are excellent opportunities for mutually beneficial and balanced trade between two countries which cannot be taken advantage of because of the rule of nondiscrimination, both countries being unable to afford buying from the United States the goods which they want to buy from each other. As long as it is impossible to shift resources, a strong argument may be made for a discriminatory policy. Such instances should, however, be justified on an _ad hoc_ basis rather than be sanctioned in advance by the principle of discrimination against U.S. goods. If this principle were applied systematically and all non-U.S. trade were to proceed on an artificially sheltered basis, the result would indeed be a growth of that trade, possibly even on a balanced basis, while the dollar problem would likely remain as critical as ever. Such a situation would, of course, provide the dollar-short countries with an excellent opportunity for pointing out that since they have achieved growing and balanced trade with all countries except the United States, the fault must obviously lie with the United States which "does not make enough dollars available," "does not behave like a mature creditor country," etc., and has therefore to take the responsibility for the shortage by providing further loans and grants.

It is not intimated here that discrimination is being advocated with this design in mind. The partisans of discrimination live much more in the past than in the future. The origin of the doctrine is the experience of the 'thirties when it would have been most important to isolate as much as possible the effect of the sudden halving of American imports of goods and services. Rather than to permit the propagation of the depression by deflation, devaluation or nondiscriminatory import cuts, it has been pointed out that the countries affected by a depression starting in another area ought to take domestic compensatory measures combined with discriminatory exchange controls.1/ The problem is not to circumscribe and to offset the

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1/ Robert Triffin, _National Central Banking and the International Economy_, Postwar Economic Studies No. 7, Board of Governors, Federal Reserve System. That the origin of the doctrine of discrimination lies in the preoccupation with a depression induced by a foreign country appears quite clearly from the League of Nations report, _Economic Stability in the Postwar World_ (1945, pp. 245-247) quoted by Triffin.

effects of an American depression, but to let the dollar shortage have its full effect in producing a diversion of exports to hard currency areas, and in general to shake loose and readjust old and new trade patterns so as to permit a progressive reduction in U.S. foreign aid shipments. The advocates of discrimination are fighting the last war, and if they win out, the present war against the dollar shortage may well be lost.

The preceding argument stresses the dangers of a policy based on the belief that the scarcity of dollars makes a systematic policy of discrimination necessary. In itself, however, the opposite policy is certainly not sufficient to make a contribution to the cure of the dollar shortage. The effect of nondiscrimination on trade may be roughly compared to the effect of disinflation on production.[1] By freeing resources, both make possible their redirection into patterns which will reduce the dependence of Europe on outside aid. The actual implementation of this redirection is a task which requires that the opportunities offered by disinflation and nondiscrimination be seized upon by intelligent planning and deliberate policy.

1/ See this Review, August 24, 1948.

THE CASE FOR DISCRIMINATION - II

Randall Hinshaw

Within the past year have appeared two important papers by Professor Ragnar Frisch on the problem of restoring a workable multilateral pattern of international trade.[1] Professor Frisch, while fully sharing the opposition of most economists to bilateralism, appears to be of the opinion that under the conditions likely to prevail in the future, an effectively functioning multilateral system must abandon the principle of nondiscrimination. This view is gradually gaining wide acceptance, and its popularity, particularly in more sophisticated circles, will doubtless be enhanced by the authority of such an eminent economist as Frisch. Nevertheless, the case for discrimination, even as Frisch presents it, is considerably less impressive than may appear at first sight.

In his earlier article, which was reviewed by the present writer in the May 18 issue of this Review, Frisch demonstrated that, under certain assumptions, balance-of-payments difficulties can be corrected with less injury to the volume of international trade by discriminatory than by nondiscriminatory import restrictions. It is clear from a careful reading of this paper that the analysis provides no case at all for uncoordinated discriminatory action, and that only a very high degree of international cooperation would assure the superiority of discrimination as a means of achieving balance. It would seem, however, that if such a high degree of

1/ The first article, entitled "On the Need for Forecasting a Multilateral Balance of Payments", was published in the American Economic Review for September 1947. The second paper, which originally appeared as a United Nations memorandum entitled "Outline of a System of Multicompensatory Trade", is to be printed in the Review of Economics and Statistics for November 1948.

cooperation were to be attained, it could just as easily be employed for a more rational end than the essentially restrictive goal of minimum-contraction-via-discrimination. Indeed, under these conditions it should be possible to set up as a realistic objective the optimum level and composition of international trade.

In a somewhat limited sense, this is the possibility with which Frisch is concerned in his second paper, in which he presents a proposal which clearly assumes a high degree of cooperation among the participating countries. The proposal is designed to break the present deadlock of bilateralism in Europe by a method which attempts, within a discriminatory framework, to maximize the overall gain from trade as measured by official ratings of import and export priority. The balancing of international accounts would be accomplished by the directives of a central agency, or "Bureau of Compensation," which would determine the pattern of international trade among the participating countries in accordance with a mathematical formula.

Under the plan, applications would be required for all imports. A given application would be reviewed not only by the prospective importing country but also by the prospective exporting country. In each case, the application would be either categorically rejected or conditionally accepted. If conditionally accepted, an application would be assigned both an import priority rating by the prospective importing country and an export priority rating by the prospective exporting country.

These conditionally accepted and officially rated import applications would provide the basis for the decisions of the Bureau of Compensation. The volume of international trade would be limited by the volume of these applications (expressed in terms of a common value unit), but only in rare cases would the volume of trade reach this maximum, since the trade must satisfy two conditions: (1) the exports and imports of each country must balance, apart from a tolerated deviation, and (2) the gain from trade, as measured by the official priority ratings, must be maximized in the manner prescribed by the agreed formula. The satisfaction of these conditions in most cases would require the rejection of a portion of the conditionally accepted applications.

Professor Frisch devotes little space to the mathematics of his scheme, and apparently is of the opinion that this aspect could be satisfactorily handled in various ways. The particular method which he suggests involves the maximization of what he calls the "global priority surplus." In general, this operation would include the following steps: (1) expressing all conditionally accepted applications in terms of a common value unit, (2) weighting the applications separately by their respective import priority ratings and export priority ratings, and (3) securing such a distribution of imports and exports that the <u>difference</u> between aggregate weighted imports and aggregate weighted exports is maximized. The maximization must be achieved in a manner consistent with the condition that, for each country, (unweighted) exports shall be equal to (unweighted) imports (apart from the tolerated deviation). This is an essentially simple problem in mathematical technique which Frisch relegates to a footnote. Since the purely mathematical issues are really secondary in Frisch's proposal, they will not receive consideration in the ensuing discussion.

The problem which Frisch attacks is one of extreme complexity and intractability, and the proposed solution has the originality and ingenuity which have long been associated with Frisch's distinguished work in the field of mathematical economics. As he rightly emphasizes, new situations require bold and unconventional thinking. Nevertheless, the uneasy reception which Frisch fears may be accorded his proposal would seem likely to materialize, and to be based, at least in part, on considerations having little to do with the novelty of the underlying ideas. Unfortunately, the exposition of the plan is highly condensed, and is not explicit on certain points which require an explicit statement for a just appraisal. The following observations are therefore presented in a somewhat tentative spirit, pending a more extended elucidation of the proposal.

Whether Frisch envisages his scheme as a transitional or as a permanent device is not entirely clear, but it is in the former role that the proposal has the greater appeal. As a permanent method of balancing international accounts, the plan would appear to have certain serious limitations. In the first place, the scheme involves a much more comprehensive supervision and control of international transactions than is the case even at the present time. Under the plan, all international transactions involving the transfer of goods and services would have to be scrutinized not only by the prospective importing country but by the prospective exporting country as well. Even under present conditions, export transactions are largely unfettered by official regulations, and only in rare cases does a country pass upon each individual sale.

A more fundamental point is that the proposal clearly provides for a discriminatory form of multilateralism. It is expressly indicated that in the determination of export priority ratings, the destination of prospective exports would be a major consideration, and there is nothing in the plan as set forth to prevent import applications from receiving discriminatory treatment. Presumably, import applications filed in the same country for the same commodity--but from different sources of supply--might be assigned very different priority ratings. Under these conditions, the way would appear to be opened for comprehensive discriminatory action on the part of all participating countries.

Discrimination within this framework presumably would be largely governed by balance-of-payments criteria. As Frisch indicates, exports to "hard-currency" areas outside the system (and to "surplus" countries 1/ within the system?) in general would receive higher export priorities than exports to "soft-currency" or "deficit" countries. It is apparently contemplated that import priorities would be affected by similar considerations. For example, prospective imports of non-essentials from hard-currency or surplus countries presumably would receive lower priorities than prospective imports of the same items from soft-currency or deficit countries.

Under these conditions, price and comparative cost would appear to be secondary considerations in international trade. Price of course would be a prominent factor influencing the decisions of those requesting permission to import, but in the final pattern of trade, as determined by the Bureau of Compensation, imports of a given commodity would not necessarily be obtained from the cheapest source.

1/ I.e., countries which, before the balancing formula is applied, tend to show an export surplus.

In this connection, it is interesting to note that Frisch does not discuss the subject of exchange rates, except to indicate that, under his plan, trade would be carried on at "determined" exchange ratios. This omission should perhaps not be the occasion for surprise, since there is nothing in the logical structure of the proposal to indicate that the subject of exchange rates is fundamental. Under Frisch's scheme, the balancing of international accounts could be achieved within widely different patterns of exchange rates. This indeed appears to be the essential function and justification of the proposal, for if a given constellation of exchange rates were to achieve balance by itself, there would be no need to apply a balancing formula.1/

But this seems to be simply another way of saying that the plan is essentially a method of securing international balance by a sort of ingenious fait du prince which conceals the underlying disequilibrium in international price, income, and productivity relationships. In situations where the trading situation is highly unbalanced before the balancing formula is applied, one is inclined to wonder how rational from any point of view the pattern of trade as determined by the formula really would be. In particular, one is led to wonder how equitably the gain from trade would be distributed.

1/ It is not clear from Frisch's paper whether he would apply the balancing formula to a situation in which the trade matrix, apart from the tolerated deviation, was already in balance. Presumably he would not, even though the gain from trade, as measured by the official priority ratings, might be less than the attainable maximum. At any rate, it would seem difficult to justify a distortion of an already balanced trade based on the free choices of individual consumers, in order to make the trade conform to the somewhat arbitrary requirements of an abstract formula based upon the valuations of the state, particularly since the latter valuations might themselves be largely influenced by purely balance-of-payments considerations.

ANNUAL REPORT OF THE SWISS NATIONAL BANK FOR 1947 Rosa Ernst

Summing up the economic trends during the year 1947, the report first of all points out that last year was characterized in Switzerland by a continuing boom (though not equally noticeable in all branches of the industry), by unusually high imports and exports, and by a tightening of the money market toward the end of the year.

The postwar boom continued despite expectations of a recession in some quarters. Contributing factors were a greater volume of tourist trade, an increase in prices and wages, and a very high level of employment. The note circulation expanded throughout the year, and especially in the fourth quarter, reaching an all-time high of 4,383 million francs (1,012.9 million dollars) at the end of December. This represents an increase of 293 million francs (or 7.2 per cent) as compared with an increase of 256.0 million (or 6.7 per cent) during the calendar year of 1946. The expansion of the note circulation took place in spite of the fact that the Government secured a budgetary surplus of 320 million francs during the year. It may be mentioned, however, that since the end of the war there has been a sharp reduction in the rate of increase of the note circulation, as given below:

Year	Per cent increase of note circulation over previous year
1941	2.8
1942	12.9
1943	15.6
1944	16.4
1945	8.1
1946	6.7
1947	7.2

The report points out that one reason for the expansion of the note circulation may have been the tendency for increased hoarding due to the unsettled political situation on the Continent. Early in 1948 there was the customary gradual drop in the note circulation which reached a low of 4,024 million francs on February 23, fluctuating thereafter, and reaching 4,221 million by the end of June.

The total gold holdings of the Bank at the end of the year amounted to 5,256.2 million francs (1,214.7 million dollars), an increase of 6.4 per cent as compared with one of 3.6 per cent the year before. Of this amount, 1,849 million francs was kept in the country, and 3,407 million abroad. According to the law, the minimum legal note cover requires a reserve in gold of 40 per cent which, since 1940, may include gold held abroad. At the end of 1947, the gold holdings amounted to 119.9 per cent of the note circulation. The amount of 5,256.2 million francs does not include 610 million francs of gold still held by the Government at the end of 1947 under the gold sterilization program. The National Bank continued to buy gold at the rate of 4,869.80 francs per kilogram fine gold as has been its custom since 1940. In the course of the summer the Bank restricted and, on September 9, completely suspended all gold sales in the free market which, since the beginning of the year, had amounted to about 480 million francs. The reasons for taking this step were a greatly increased demand for gold on the part of private individuals, largely for purposes of speculation and smuggling operations, and the desire on the part of the Swiss authorities to cooperate with the International Monetary Fund in its efforts to prevent gold transactions at premium prices. It was emphasized at the time, however, that the National Bank would make gold readily available for international payments as well as for legitimate industrial uses of gold.

As mentioned above, the Government at the end of 1947 held gold in the amount of 610 million francs, representing a drop of about 629 million as compared with the end of 1946. Included in this decrease is an amount of 250 million francs (about 58 million dollars) turned over by the Swiss to the Allies in accordance with the terms of the Washington Agreement of 1946. 1/ The total amount of gold held by the Bank and the Government at the end of 1947 thus amounted to 5,865.9 million francs, or about 1,356 million dollars. Early in 1948, the Bank began taking over a substantial amount of the Government's holdings, thus increasing its own gold reserves by over 300 million francs between January 6 and 15, 1948. By the end of May the Bank's gold holdings rose to 5,672 million francs, while those of the Government dropped to 174 million in the same period. When the first transfer took place in January, it was emphasized that "the increase in the Bank's gold holdings was not due to international payments, but was the result of a transfer from the Government to the Bank of that part of the Government's holdings which represented the countervalue of assets blocked for currency reasons as a result of the dollar arrangements made during the war years." With their transfer to the National Bank, these assets were progressively unfrozen. At the same time there appeared on the balance sheets of the Bank an item under the heading "term liabilities" which is believed in part to consist of assets blocked in connection with the sterilization program. By the end of May 1948 these term liabilities rose to 456 million francs.

While the gold holdings of the Bank registered a decided increase, the foreign assets of the Bank decreased by 56 million francs from 158 at the end of 1946 to 102 million at the end of 1947. Almost 98 per cent of the foreign exchange consists of U.S. dollars, which may also serve as legal note cover. Below is shown the change in the gold and foreign exchange position of the Bank during 1947 as compared with the end of 1946:

	Increase or decrease (-) (Million francs)
Gold holdings	
Dec. 1946 — 4,949.9	
Dec. 1947 — 5,256.2	306.3
Foreign exchange holdings	
Dec. 1946 — 158.0	
Dec. 1947 — 102.4	-55.6
Total change	250.7

1/ See this Review, June 3, 1946.

This increase of 251 million, compared with 167 million the year before, is all the more remarkable in view of the unfavorable balance of trade which shows an import surplus of more than 1.5 billion francs during 1947, or more than double the import surplus at the end of 1946. The trend seems to continue in 1948, since at the end of only five months the import deficit had risen already to over one billion francs, and if it is assumed that the same ratio will prevail for the remainder of the year, the deficit may well rise to over 2 billion francs by the end of 1948. However, it is believed that for the year 1947 revenues from tourist expenditures, from capital transfers, and other active items in the balance of payments more than offset the passive trade balance. It may be quite different in 1948, since it is estimated that income from the tourist industry during the current year will be appreciably lower, because of travel restrictions imposed by many foreign governments and unseasonable weather in the early summer.

In the course of the second half of 1947 the money market became somewhat tighter with a resulting increase in interest rates. Thus the private discount rate, which since 1940 had been kept at 1-1/4 per cent, began to rise and reached 1-1/2 per cent in January 1948. The official discount rate of the National Bank remained at 1-1/2 per cent, which rate went into effect on November 26, 1936.