New Complications in Commercial Policy

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NEW COMPLICATIONS IN COMMERCIAL POLICY

By S

IT MAY be that the multi-colored globes that stand in school-rooms are still found. Out of established habit statesmen may still make declarations in terms of the whole collection or community of nations. It is possible that the inter-governmental machinery at Geneva, called the League of Nations, can repair its broken lines and dramatically bring back into the circle of consultation the important countries now missing. But for the passing day, at least, in all the realms of actuality which make up contemporary history, the world is becoming increasingly divided. A system and conception of general relationship and common rule that in the economic and financial sphere came into existence before the Great War, and in the political sphere was striving to be born after the war, is speedily being lost in a scheme of relationships more segmented than has existed in the experience of living man.

The system to which the nations seem to be turning as the depression completes its fifth year has two outstanding tendencies:

First, international commercial and financial affairs are being increasingly subjected to and made dependent upon the will of governments. The exchange of goods and the payment therefor, the operation of international private finance and the fate of investors in foreign securities, are becoming increasingly tangled in and directed by government action and arrangements between governments.

Second, governments are dealing with each other (and thereby controlling the dealings of their citizens with each other) less and less in accord with the terms of a generally impartial relationship, and more and more in accordance with the terms of infinitely varied and specialized bilateral agreements. Contracts, treaties, and traditions of international law, providing for equality or identity of treatment, are being discarded. By pairs, as in some involved dance in which no one seems to know the music or to be certain of his partner, each country seems driven by necessity to move.

These generalizations require explanation. International commerce has always been extensively controlled by governments, and
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the conditions made by any one government have always shown some measure of variation and of special relationship as between producers of different outside countries. There were some privileged relationships and some extraordinary barriers which originated in fear. But the prevalent basis of international trade since the famous Cobden-Chevalier Treaty of 1860 has been that of equality of treatment. There was a vast world trade directed by the economics of the market-place, in which producers of different countries generally met the same terms. Governments concerned themselves with the state of their trade relationships with the whole of the outer world rather than with particular parts of it. The volume of trade between any one country and each of the rest was deemed primarily to arise from the difference in underlying circumstance of nature or economic development. Thus the inequality in the volume of trade moving between any one country and any other single country was understood to be, in the main, natural. It consequently was not deemed cause for marked rejoicing or resentment that one country purchased much more largely from the second country than it sold to that country; it was believed that the trade relationship with the whole of the outside world was the sole sound basis of policy, and that the mechanism of the financial markets, the movements of gold and relative shifts in costs and prices would, in general, bring about a sound adjustment in that total relationship. The important trading countries during the half century before the war acted on this general set of judgments. That the system was then satisfactory was shown by the growth of world trade, and by the fact that none of those countries had to revalue their currencies or resort to other extreme measures. A world economic relationship existed and its results appeared to be mutually beneficial.

So, too, in the financial field. Countries borrowed wherever they could find the best terms. Often loan issues were divided between different lending markets, the same obligation being taken towards all alike. A general rule of equality of treatment towards all investors, irrespective of nationality, tended to be accepted in both lending and borrowing countries. The business of international lending and borrowing was, it is true, closely regulated and often deflected, in accordance with national policies, by the governments of the lending countries. Nevertheless, the loan contract once settled, the relationship thereby established
between the borrower and the diverse lenders carried high authority and was regarded by all parties concerned with substantial respect. Furthermore, governments were rather slow to be moved into action on behalf of their investors. Protection was given but guardedly and the principle of equality of treatment was retained.

Acute transfer problems seldom arose to complicate the foreign investment situation before the war. The flow of international trade was greater and more regular compared to the existing international debt burdens than has been the flow of depression trade; no such terrific decline of international trade such as that of the past five years occurred. Again, with the exception of the money poured into Russia and a few of the smaller European states as a part of the pre-war diplomacy, there were no important instances of great over-lending such as came into existence after the war. Failure to meet debts arose primarily from budget difficulties or from conflicts such as the Balkan Wars. Under these circumstances, debtor governments facilitated the internal cost and price movements that made payment possible; to do so was the essence of the debtors’ obligation. The governments of the creditor countries often stood beside their bondholders in the conferences, but seldom pressed a special advantage to the final limit to serve the bondholders of their own nationality to the injury of bondholders of other nationalities. True, the present-day tendency was there in germ and was occasionally manifested. But, in general, debt situations retained their private character and in case of difficulties the governments of the borrowing countries were left free to treat all their creditors alike, and the general revival of trade was trusted to pull all out of the hole. But now in this sphere, as in the trade sphere, a rapid change has taken place. The treatment accorded foreign investors is becoming a matter of special relationships between the governments of individual countries.

II

The new tendencies first took definite form as among the smaller states of Central and Eastern Europe. These states have had a desperate struggle for economic survival ever since the war. Virtually all of them have found it necessary greatly to limit external payments on debts and forego imports through exchange controls. Despite the attention they received from the political
and economic specialists of the outside world, and despite the many schemes elaborated in foreign offices, no agreement for trade interchange throughout the region has been effected. Instead, across the extremely complicated gridiron of political and economic interests thin and wavering trade bargaining lines have been drawn in all directions.

These agreements were designed to facilitate a limited movement of complementary trade past the extremely intricate governmental barriers of protective measures and exchange controls. They are highly particularized in character, and contain a multitude of special trade arrangements such as customs quotas, tariff quotas, direct barter arrangements between governmental institutions, and the like. Their duration is short, and they have been constantly revised. Often essential details of these agreements have been kept secret between the parties.

The negotiation of these agreements has been guided very largely by the attempt of each country to insist that every other country buy directly as much from it as it purchases from the other country. Often they are accompanied by arrangements of a "clearing" character, whereunder funds arising from the sales of goods between the pair of contracting countries are deposited in special clearing offices and used only for payments between the two countries; such isolation of funds was insisted upon in each case by the country that had afforded the better market in the past. Many of the trade agreements between these small countries and the larger continental Powers are of the same character. In a few of the arrangements, such as those recently concluded between Italy on the one hand and Austria and Hungary on the other, special political relationships have entered into the framing of special terms. Although the United States and other countries had commercial agreements with various countries in this region based on the unconditional most-favored-nation principle, the provision appears to have lost all force. All general rules or obligations have been scantily heeded in the making of this new web of special trade agreements.

Most observers of affairs in this area have recognized that if all these small states are to live prosperously alongside each other, a regional or series of regional commercial pacts would be required. There has been a disposition to agree that these countries might well extend trade advantages to each other which were not shared with the rest of the world. But the agreements
that have come into existence represent no broadening of commercial intercourse throughout the area; they permit what is virtually the minimum of trade on strictly offsetting bilateral terms.

In that region the principle of equality of trade relationships was never solidly established. However, in the commercial policy of the British and Dutch Empires it was a cardinal rule throughout the past half century. In both it has now become gravely impaired. The British Empire has intensified its scheme of imperial preferences to such an extent as to create an imperial trade relationship essentially different from that between the different parts of the Empire and the outside world. In addition, the United Kingdom and various of the Dominions have entered into bilateral trade agreements with foreign countries containing arrangements that, by their nature, could not be generalized. In some of the treaties negotiated by the United Kingdom, the chief British demand has been the creation by other countries of quotas designed to secure a favored place in the market for British goods, particularly coal. Correspondingly, the British Government is increasingly partitioning off the British market for foodstuffs on a quota basis, and bartering off the quota fractions in return for privileged market advantages for British goods. In one instance at least, the treaty with Argentina, the British Government secured for its trade the only really effective exclusive privilege that is important under the conditions existing in Argentina today, the prior right to the foreign exchange arising out of purchases of Argentine goods by Great Britain. The obligation thus imposed on Argentina has resulted in a great curtailment of Argentine purchases elsewhere and has forced a shift in trade channels. Advantages of an even more exclusive character have been demanded of the Uruguayan Government for British goods on the basis of Uruguay's dependence on the British market.

This line of policy was adopted by Great Britain after the disappointment of hopes that other countries would reduce their trade barriers sufficiently to permit a substantial revival of world trade along the old lines. Now British policy is reaching with increasing assertiveness along the other line—that of seeking for British interests a privileged position under trade and exchange control arrangements. Wherever the opportunity of entry into the British market or wherever a political or diplomatic
dependence can be used to secure special advantages to British trade or investment, that situation is being pressed to the utmost. True, the British Empire has maintained the most-favored-nation principle (excluding imperial preferences) in its direct trade relationships with some other important countries, notably the United States, but alongside of this long-standing relationship it has been entering into others of a radically different character.

The shift in the principles of Dutch commercial policy has been even more reluctant than the British. But that trading country also has been entering into an increasing number of bilateral trade agreements, primarily with the nearby countries of the Continent, whereunder the exchange of goods between itself and these countries is arranged in accordance with specially privileged agreements designed to bring about a more nearly equal balance of bilateral trade. In order that this bilateral bargaining may be more successfully effected, trade controls, such as import quotas and customs quotas, have been introduced; the former régime of trade conducted on equal terms with all countries alike has been much modified. The tendency to force a balance of purchases and sales, country by country, has found its place in Dutch commercial policy as in British.

The present commercial policies of the German Government present all phases of the bilateral trade scheme to an extreme degree, both in form and in method of employment. The German Government has recently modified all the trade methods and agreements on which equality of trade relationship rested. While endeavoring to maintain its present place in the markets of those countries which buy more German goods than the other way about, it has addressed itself with determination to all countries which provide Germany with a greater amount of goods than they buy. Faced with the necessity of a substantial export surplus if it were to meet its external obligations and not restrict its purchases of foreign goods, the German Government has pressed its claims for special market opportunities upon the whole world, but with especially intense vigor on those countries for whom Germany is a good customer. By this determined bilateralism, the former channels of trade between Germany and the outside world, established by underlying physical and economic circumstances, have been vastly deflected.

To pursue this line of policy more effectively the German Government has denounced some commercial agreements, has de-
developed trade control measures the use of which were not controlled by those commercial agreements to which it remains a party, and has ignored the treaty commitments which could not thereby be rendered unimportant. Among the treaties in question has been the unconditional most-favored-nation treaty with the United States. The guarantee in this treaty of equal rights for American trade has largely lost significance because of the new measures of trade control now employed in Germany. Among these methods has been the employment of a quota system without any fixed basis for allotting quotas on particular commodities as between different countries. But more important has been the establishment of government import purchasing boards or monopolies. These import monopolies are free to buy irrespective of the price offers received from the producers of various foreign countries, and their purchases can be directed along the lines of government preference and in accordance with the terms of special agreements. Further, under the intricate exchange control arrangements now established in Germany the governmental authorities are in a position to dictate for what purposes exchange should or should not be made available.

These in sum create a commercial policy situation in which the ordinary economics of the market-place and the practice of equality of treatment are completely subordinated to the trade, financial and political relationships between the German Government and each other government with which it deals. They are the armory of a system of bilateral and discriminatory trade agreements; they are the means by which other countries which sell goods to Germany are to be reluctantly brought to purchase more German goods. This German trade policy represents the extreme application of methods and principles employed previously by the smaller continental countries (the monopoly system in some respects is like the method employed by the Soviet Government).

The bilateral trade which moves today does so in an atmosphere of reluctant and half-embittered concession, and only to the extent that governments can agree. It is irregular trade, thrice bound round by government red tape and always subject to interruption or destruction. The new trading world is one of special claims and of special advantages, of trade reserved for those who may or can compensate as direct purchasers. In short, it may be said that the basis of the international trade of the world during
The past half century moved from comparatively "free trade" to "protected trade," and it has now entered a period not only of protected trade but also of "reserved trade."

Under the previously developed rules, price and monetary policies of governments tended to conform to the trade movement. Through the delicate mechanism of adjustment of the international gold standard there was preserved a changing balance between the economy of nations. Under the type of bilateral trading system described, trade is compelled by struggling governments to conform to the limitations of such guarded bilateral bargains as may be struck.

The pursuit of this policy may enable governments for the moment to escape some difficult internal adjustments, but it will not foster trade. It has been calculated that if nothing but direct bilateral trade had taken place between the twenty leading trading countries of the world in 1933 (that is, if the amount purchased by each country from each other country had been reduced to the amount sold to that country), approximately one-third of the already shrunken total would have been suppressed. The inner logic of the policy tends to be that the sole benefit of international trade arises from the amounts exported, and that, irrespective of underlying physical and economic reasons for trade, those who purchase goods from a nation deserve corresponding orders, and those who do not may be justly penalized in the form of discriminatory treatment. The difficulties in negotiations incident to the making of these agreements are great. The habit of careful measurement of assumed benefits makes for criticism on minute grounds. Many of the price advantages that international trade conveyed are lost.

It is possible to argue that under the difficult depression circumstances in which countries have found themselves — circumstances threatening particularly the stability of currencies — this line of development has been inevitable. It is similarly possible to argue that the world trade in the past led to such an unbalance of economies as in the long run to be unsound. But it cannot be expected that the new arrangements will serve the course of trade as well as the old; and it is greatly to be feared that these arrangements, by making trade a matter of discriminatory terms rather than a general rule, will contribute to the many animosities that already divide peoples.

Under these circumstances, can any countries continue to
follow a policy of equality of trading with all other countries on
the same terms? This is a problem which, it may be anticipated,
the American Government will soon have to consider.

III

The basis of international financial relations is being similarly
modified. The former prevailing attitude, as has already been
explained, was that international loan transactions were pri-
marily private transactions and that any necessary adjustment in
the terms established by the contract should be worked out
between the parties to it. Certainly it was generally assumed that
the borrower's obligation ran equally to the bondholders of all
nationalities; and, except in time of war, treatment of bond-
holders of different nationalities was not affected by the state of
trade or by monetary relationships between the borrowing coun-
try and the various other countries of which the lenders might be
citizens. Borrowing countries expected and were expected to
draw on the fund of foreign exchange that arose from their trans-
actions with the whole of the rest of the world, and to distribute
payments wherever they might be due. When borrowers had
difficulty in meeting total obligations, the assumption was that
whatever reductions of service were necessary would be made
without discrimination on the basis of nationality. All of these
suppositions were embodied in the loan contract and were in
general accepted by the governments of the lending countries.

In many instances these attitudes are now being replaced. In
instances where debtors have become embarrassed (especially
where lack of exchange has led to the creation of an exchange
control, and not even private debtors otherwise solvent can meet
their foreign obligations), those governments which are in a
position to use their trade or diplomatic relationships as weapons
to secure payment for their own citizens tend increasingly to do
so. The cumulative losses suffered by investors in foreign securi-
ties fostered a struggle between the creditor interests of different
countries, and in this struggle the support of governments has
been enlisted. They have induced or forced the borrowing govern-
ment to provide funds for their bondholders irrespective of the
effect on the exchange situation or of the discrimination created
vis-à-vis bondholders of other nationalities. In most instances this
has been worked out through various forms of clearing, under
which funds are earmarked for payment of debts due to persons
of a particular nationality. In turn, borrowing countries, experiencing a lack of available foreign funds and being subjected to pressure in some directions, have tended to take the position that the treatment they would accord to debts running to persons of different nationalities would depend on the trade opportunities made by each of the governments concerned. Out of these tendencies there are arising manifold bilateral agreements between governments having to do with the discharge of debts. These agreements have in many respects replaced the original loan contracts.

The new policy of seeking and enforcing bilateral intergovernmental agreements to insure debt payment arose first in regard to the commercial debts and other short-term obligations that became banked up behind the exchange controls created in the debtor countries. This mass of short-term debt was frequently the working capital of exporting concerns and of foreign-owned enterprises located in the borrowing country. To rescue the holders of this short-term debt, various countries (notably France, Switzerland and Holland) whose citizens purchased more in the various other countries of the Continent and South America than they sold to these countries, began to use, for purposes of debt collection, clearing or compensation arrangements of the type that had already come into existence in the trade between the various smaller countries of Europe. They provided that all or a certain portion of the funds arising out of foreign sales in their domains should be put aside to discharge the debts due to their citizens. All of these agreements, by marking off from the total funded exchange an amount to which debtors of one nationality have priority, incidentally create discrimination vis-à-vis the debtors of those countries whose governments either do not desire to pursue the same policy or are not in a position to do so.

In some instances and to some small extent these special arrangements for meeting commercial or other frozen indebtedness have been accompanied by agreements which facilitated payment by opening up new market opportunities for the goods of the debtor nation. In some instances, in fact, the isolated exchange arises largely from such sources. But in every case — and the number of them is increasing apace — the treatment accorded the debts due in each country becomes dependent not on the total trade relationships between the debtor country and the rest of the world, but on the particular bilateral trade relationships. Further,
no matter what the origin of the debt, it becomes not a matter of private obligation between lender and borrower but an obligation whose fate is dependent on the inter-governmental relationship. To the natural concern of the creditor in the past about the credit worthiness of his debtor and the general trade situation of the debtor country, there is now added the necessity of reckoning with all features of the bilateral trade relationship.

The extent of this development up to the present should not be exaggerated. In many important instances, governments which have been forced to reduce payments on external obligations, and to furnish their citizens only limited amounts of exchange to meet external obligations, have accorded the same treatment to all external creditors irrespective of nationality and without resort to special agreements of the type described. The Argentine and Brazilian Governments, for example, when there was a lack of exchange to meet frozen commercial credits, made the same offer for conversion of these credits into funding bonds to creditors of all nationalities.1 But the tendency for special bilateral arrangements to come into existence wherever exchange control exists is very strong; and in many instances a debt is worth no more than the ability or disposition of the creditor's government to force or facilitate its payment.

The same tendency is affecting the treatment of funded debts. The situation that has developed is most vividly illustrated by recent events connected with German external indebtedness. On the grounds of an extreme shortage of foreign funds the German Government has suspended payment on all German external obligations, including the obligations of the Reich Government itself, notably the Dawes and Young loans. This suspension affected a great variety of loan issues; something like 115 issues had been sold in the American market alone. Vigorous dispute has arisen as regards the necessity for this action and the responsibility of the German Government itself in creating the exchange situation which now confronts it. But this is not the place to undertake the intricate task of weighing causes and responsibilities.

Whatever these causes and responsibilities may be, various governments whose citizens were investors in German obligations have taken measures to attempt to enforce payment. Holland

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1 The Argentine Government, however, in accord with the Roca agreement, is giving preference to sterling holders of frozen credits that came into existence on a date later than this transaction.
and Switzerland took the initiative. Their investment in German securities is high compared to their national incomes. Both countries have been large purchasers of German goods; and their purchases are greatly in excess of the sale of their own goods within Germany. Utilizing this situation, they secured agreements from the German Government providing better terms of payment on the securities which they held than the German Government accorded to foreign creditors of other nationalities. These agreements contained features which to some extent connected debt service with extra purchases of German goods, and have been defended as creating the exchange required to meet the service. But the line between "ordinary trade" and "extra trade" is extremely hard to draw; merely by shifting an import duty or regulation a country can shut out goods which later can be put down as "extra" imports. A study of the agreements between Germany on the one hand and Holland and Switzerland on the other affords scant ground for believing that they have fostered any substantial volume of trade that would not have taken place otherwise. They may be regarded in essence as a means of creating what was deemed a defensible basis for continuing service on German obligations owned by persons of Dutch and Swiss nationality, while suspending that service on the same securities held by persons of other nationalities.

It is to be surmised that the Reich at first did not welcome these special agreements. In fact, at a meeting with the creditor representatives at the beginning of 1934 the German Government agreed to give them up. But in connection with the German suspension they were renewed, and in later controversies the German Government has vigorously defended the principle underlying them. Agreements have been struck with the British and French Governments providing for the continuation of service on the Dawes and Young loans in the hands of British and French citizens. These governments have secured this result by threatening to impose clearing agreements on German exports to their territories. The bilateral trade situation was the decisive factor.

No loan agreements could contain more unequivocal pledges of equal rights to all investors irrespective of nationality than those given to the Dawes and Young loan issues. Further, in the case of the Dawes loan, a direct request was made by the Allied Governments to the houses of issue which undertook the loan.
Young loan was arranged for by an inter-governmental agreement, and its sale was fostered in all markets by virtue of that fact. In short, in regard to these two particular issues, not only was the German Government bound to a strict rule of equality, but the Allied Governments likewise had an implied responsibility for seeing that no discrimination arose. Nevertheless, discrimination has arisen. American investors in these issues may receive no service while other nationals whose governments could impose bilateral agreements on Germany will continue to encash their coupons. What was deemed to be at the beginning a relationship between the German Government and private investors has turned out to be a matter of inter-governmental relationship, and the telling element has been again the bilateral trade balances. No matter that the American investment aided vitally in reviving the German economy and so made possible the present excess of German sales in the Allied countries, and no matter that present American purchases in other parts of the world create exchange with which, let us say, the British can buy German goods. All of these indirect phases of the situation, as well as the question of Germany's total transfer capacity, are submerged before the dominant fact of the bilateral trade situation.

The German Government has asserted that it was not discriminating because it was willing to negotiate with the American Government an agreement whereby in return for extra direct trade advantages service would be rendered on the American investment. It has virtually asserted that the willingness of particular countries to buy more German goods was the real test of the obligation to pay, irrespective of the fact that differences in economic and physical circumstances must naturally create differences in bilateral trade relationships. The American Government has insisted that the debt obligation was one to be handled primarily between the German Government and the private investor and should not be made into a matter of inter-governmental relationship. There the matter stands deadlocked at the time these lines are written.

This situation may reproduce itself wherever a debtor government finds difficulty in acquiring sufficient foreign exchange to meet external obligations. That it is a temptation for any government to be able to shift the basis of obligation from the loan contract to the trade conduct of the creditor country is obvious. Formerly, it was judged that the responsibility for making such
adjustments as were required to make debt payment possible lay primarily upon the debtor country. Under the German attitude the responsibility for making the adjustment is placed upon the creditor.

IV

In the scope of an article it is impossible to attempt to weigh the final meaning and result of these developments. It may be that in some instances the new bilateral arrangements will make possible a certain limited movement of trade that otherwise would not occur. And the desire to obtain payment on debts may lead some countries to pursue slightly more liberal trade policies than would otherwise be pursued.

On the other hand, it seems plain that the extension of the present tendency will result in a world thoroughly divided up into segments, with a vast crisscrossing of competing interests. The idea of equal treatment as between all countries will be entirely discarded and replaced by the practice of exceptional rule and special treatment. In numerous situations which formerly were left to the natural adjustment of private interests, governments will be active and busy rivals. The conduct of international trade and the discharge of debt obligations will be attended by the multiplication of government regulations and all the delays incidental to diplomatic bargaining. Within each country, trade and finance will be brought into an intensely close relationship with government in all international operations. The power of national states to agree — already strained — will be subjected to further tests. If it proves inadequate, the Leviathans and Europas of the present day will be but the greater galleons of a world as little bound together by general trade and rules of impartial treatment as was the world of Sir Francis Drake.