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THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

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Multilateral Clearing[1]

By E. F. Schumacher

Let us assume for a start that there are certain advantages to be gained from settling international payments for goods and services by way of Clearing. The importer in country A pays for the goods he buys from country B by handing over to the Clearing Authority in his own country a sum of A-money which is deemed to discharge his debt. The exporter in country B receives from the Clearing Authority in his country an equivalent sum of B-money which is deemed to satisfy his claim.

There is little difficulty in organising a Clearing of this sort to cover the trade between any two countries. Not only payments for goods and services, patents and copyrights, but also dividend, interest and amortisation payments can be settled over Clearing. These " bilateral clearings " exert a strong tendency, unless counteracting measures are taken, to equalise the trade between the two countries concerned by either stimulating the exports of the country which would otherwise have had an import surplus, or curtailing the exports of the country which would otherwise have had an export surplus.

Let us now assume that a system of trading which enforces strict Bilateralism has certain definite disadvantages and that it would be desirable to maintain the multilateral character of trade, whereby no country finds itself under the necessity to balance its trade with any one particular other country, but can feel free to buy even from countries which are not its customers and to sell even to countries from which it does not buy.

The question then arises : Can we have multilateral clearing ?

The central problem of multilateral clearing can be stated as follows : Assume that there are only three countries, say, the United States, Britain and Poland. And assume that in the course of one year's trading America sells more than she buys, Britain sells just as much as she buys, and Poland buys more than she sells. America could be called a " surplus country ", Poland a " deficit country ", and Britain a country which has achieved " balance ". These designations refer to the *total* trade of each country ; the bilateral trade may be quite different. Polish-American trade, for instance, may come out even, which would mean (on our assumptions) that

[1] This study was carried out for the Joint Committee of the Nuffield College Reconstruction Survey and the Institute of Statistics, Oxford. It has been in private circulation since November, 1942. An earlier version, entitled *Free Access to Trade*, was circulated by the Royal Institute of International Affairs in March, 1942.

the trade between Poland and Britain showed a Polish deficit, and the trade between Britain and America a British deficit. If that is the case, America will have uncleared sterling balances in Britain, and Britain will have uncleared zloty-balances in Poland. Multilateral clearing implies that in this case Britain, having achieved (global) balance, should be " out of it ", in the sense that she is under no obligation either to curtail her imports from America, or to press her exports to America, or to curtail her exports to Poland, or to increase her imports from Poland. But Britain is released from these obligations only if the Americans are prepared to exchange their sterling-balances for Britain's zloty-balances. Why should they be prepared to do this ? Sterling balances (on our assumptions) are preferable to zloty-balances, because Britain, at least, is a country which has achieved " balance " in her total trade, while Poland is a deficit country. Why should the Americans exchange a better currency for one that is worse ? If they can be made to do so, then we can have multilateral clearing ; but if not, then the clearings will be strictly bilateral, and even the setting up of an International Clearing Office would not help.

In this connection it is interesting to note that some form of multilateral clearing exists at present on the continent of Europe. How does it work ? The answer is simple : Germany, as the supreme military power on the continent, forces the surplus countries to agree to the necessary exchanges of uncleared balances so that in the end the countries which have achieved balance (or : to the extent that they have achieved balance) are relieved of all claims and liabilities arising out of the different bilateral clearings, and the surplus countries simply remain as the creditors of the deficit countries.

The problem we have to face, therefore, reduces itself to the question : How can multilateral clearing be achieved without the application of force ?

The solution here offered might be called " Pool Clearing ". It works as follows :—

Every country sets up an independent agency called the National Clearing Fund. The various National Clearing Funds agree among themselves as to the rates of exchange by which each currency is to be related to all other currencies.

Importers (of goods and services) make all payments in their own national currency into their own National Clearing Fund. As soon as the Fund has received payment, it informs the National Clearing Fund of the exporter that payment has been received, whereupon the National Clearing Fund in the exporter's country makes payment to the exporter. Each National Clearing Fund thus receives and disburses only national currency : it receives such currency from the home importers and disburses it to the home exporters.[1]

[1] The reader will appreciate that this paragraph merely states the *theoretical* principle of Pool Clearing. In practice, the canalising of all payments through the National Clearing

Assume now that dealings on this basis are carried on for a period of, say, twelve months. At the end of the period we should find that the different National Clearing Funds can be divided into three classes :

(1) The Clearing Funds of countries which have imported more than they have exported (" deficit countries ") will have received more national currency from importers than they have disbursed to exporters and will consequently be left with a balance of cash in hand.

(2) The Clearing Funds of countries which have exported more than they have imported (" surplus countries ") will have disbursed more national currency to their exporters than they have received from their importers and will consequently be left with a debit balance.

(3) The Clearing Funds of countries which have exported just as much as they have imported will have disbursed to their exporters just as much national currency as they have received from their importers, and will consequently be left neither with a balance of cash in hand nor with a debit balance of any kind ; they will be in the same position as they were twelve months previously.

Thus the Clearing Funds of deficit countries would be left with a balance of cash in hand, and since it would be undesirable if the Clearing Funds interfered in internal monetary policy, the proper way to employ this balance would be for them to purchase Treasury bills in the open market ; similarly the Clearing Funds of surplus countries would be in need of cash and should raise such cash by selling Treasury bills in the open market. In this way National Clearing Funds would operate in a manner analogous to that of Exchange Equalisation Funds.

What, then, would be the position of ownership with regard to the various balances remaining in the deficit countries ? Let us revert to our example. America sells additional $10x$ to Britain, and Britain sells additional $10x$ to Poland. Britain having achieved balance is no longer concerned in the matter ; her national Clearing Fund has received an extra $10x$ from importers and disbursed an extra $10x$ to exporters. It follows that America owns a balance of $10x$ in Poland, although she may never have been in trading relations with that country at all. A sterling-balance, which the Americans could own, simply does not exist. Thus the question of ownership is quite clear : the surplus country owns the cash balance in the Clearing Fund of the deficit country.

Fund can be effected in a way hardly noticeable to any individual trader. The established banks would be authorised to make and accept payments against documentary evidence and would merely settle the uncleared balance with the National Clearing Fund. They would also continue to finance home importers and exporters in much the same way as before. Whether or not certain categories of in-payments or out-payments are to be made subject to special permit, is a question which every national government has to decide in the light of its general economic policy. Any particular degree of foreign exchange control is equally compatible with the system of Pool Clearing.

But what if there are more than three countries? Assume that America sells additional $10x$ to Britain, and Britain $8x$ to Poland and $4x$ to Holland. America has a surplus of $10x$, Britain a surplus of $2x$. Cash balances of $8x$ and $4x$ are held in the Clearing Funds of Poland and Holland respectively. To whom do they belong? What proportion of the zloty-balances and of the guilder-balances belongs to America and what to Britain? Not unless the time sequence of all individual transactions were meticulously studied and compared could this question be answered. The balances in the deficit countries have lost their identity. The innumerable threads of business cannot be disentangled. All that can be said, and all that should be said, is that 5/6ths of the total of balances in Poland and Holland belong to America and 1/6th to Britain. This is the decisive feature of "Pool Clearing".

It will be observed that the pooling of balances arises automatically out of the mechanism of the system. No surplus country is ever called upon to exchange one balance for another. Under a system of bilateral clearings, America—in our example—would get into the possession of sterling-balances even if Britain had achieved balance or even if Britain were a surplus country herself. To multilateralise such a system, America would have to be forced against her immediate interest to swap her sterling balances against Britain's balances in the deficit countries. There would be no country strong enough to enforce such swapping on a world-wide scale. Under Pool Clearing this whole question never comes up. Any such cash balances as appear in the various National Clearing Funds are always and inevitably the result of a deficit in the *total* trade of the countries in question. Mere bilateral trade deficits do not give rise to the appearance of uncleared balances, unless they represent at the same time deficits in total trade.

While the pooling of balances, however, arises automatically under the system here discussed, it will still be necessary to create some international machinery to give to this process its appropriate legal form. Let us assume, therefore, that an "International Clearing Office" is set up to act, so to speak, as Trustee in the pooling of uncleared balances. All cash balances accumulating (in the form of a holding of Treasury Bills) in the Clearing Funds of the deficit countries are deemed, at any time, to be taken over by the International Clearing Office, and the Clearing Funds of the surplus countries are deemed to own each a share in the Pool, equal to the size of their respective surpluses.

It will be clear that the International Clearing Office requires no finance of its own, nor does it have to create a new international currency.[1] Since it is impossible to disentangle the mass of individual

[1] If a new international currency were created, this would be of no economic significance. The holding of "a share in the Pool" would then be called a holding of "world currency", but the backing of the world currency would none the less be nothing else but the cash balances in the deficit countries.

transactions which give rise, during the course of business, to the various uncleared balances in the deficit countries and to ascribe any one particular balance, or part of it, to any one particular surplus country, the Gordian knot is cut by making all the surplus countries the joint owners of the balances in all the deficit countries. In this way, one might say, every national currency is made into a world currency, whereby the creation of a new world currency becomes unnecessary. Nor does the International Clearing Office—in *this* connection—require any special powers; it is not an agency for control, but a purely administrative body, the central accounting office for the different National Clearing Funds.

As a result of its (purely formal) operations, we get the following position: The Clearing Funds of surplus countries become indebted to their internal money markets and acquire an equivalent share in the Pool; both their debt and their share in the Pool being equal to their trade surplus. The Clearing Funds of the deficit countries are left with balances of cash in hand (equal to their trade deficits) which belong to the International Pool. The Clearing Funds, finally, of countries whose balance of trade has left neither surplus nor deficit hold neither cash nor a share in the Pool.

This system, obviously, is fully multilateral. It is immaterial to each individual nation where it buys or sells. Whether it sells to a deficit country or to a surplus country, its National Clearing Fund will disburse national currency to the exporters at home and thereby decrease the amount of cash held by the Fund or increase the debt owed by the Fund to the internal money market. Whether it buys from a deficit country or from a surplus country, its National Clearing Fund will receive national currency from the importers at home and thereby increase its cash holding or reduce its debt to the internal money market. All individual sales and purchases have the same technical effect, irrespective of the country to which goods are sold or from which goods are purchased.

They have the same *technical* effect. That is to say: there is nothing in the technical set-up of this system to induce any individual importer or exporter to choose his sources of supply or his markets with reference to his country's bilateral trade balances. Under a regime of a multitude of bilateral clearings this would be quite different: each country would always have some clearings with a trade surplus and some with a deficit. Britain, in our example above, would have ready cash for additional imports from Poland, but not for additional imports from America; America would have ready cash for additional imports from Britain, but not for additional purchases in Poland. Under Pool Clearing these differential stimuli do not come into existence. The identity of ownership of the various balances accumulating in deficit countries (and in deficit countries *only*) cannot be separately established. And the main stimulus that remains is for the surplus country to spend its surplus—*anywhere* in the world.

This is a great advantage, because it avoids the dangers and frustration of Bilateralism and allows world trade to flow according to whatever economic criteria may exist for the international division of labour, instead of setting up the arbitrary criterion of bilateral balance.

Yet while a system of trading that enforces strict bilateralism must be considered arbitrary and discriminatory, the same does not necessarily apply to a system that enforces balance in the *total* trade of each country. The principal aim, in fact, of any new system should be that the achievement of such global balance be facilitated. In this way all those problems might be solved which arise when one country achieves a surplus for a prolonged period of time and, being unwilling to increase its purchases, drains other countries of all their liquid means for making international payments (e.g. gold and foreign exchange balances) and ultimately may even force them into default. But balance, even though it solves some problems, is not an end in itself. The task is to achieve balance at the right level—and that level should, as far as possible, be determined by those countries that are in need of, and willing to purchase, foreign goods. This is the only possible meaning that can be attached to the " Free Access " clause in the Atlantic Charter, which promises " enjoyment by all States, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity ". Under a regime of bilateral clearings each country has, one might say, free access to the trade and raw materials, not of the world as a whole, but only of those other countries which are its customers. Under Pool Clearing access to trade is universally free.

Yet, no matter what is the technical set-up, every country must ultimately pay for what it buys, which means, in the long run, that it must achieve a position in which it can supply as much in goods and services to the rest of the world as it receives. This does not deny the possibility of making international gifts, grants-in-aid, Lend-Lease, or reparation payments. But they fall outside the scope of our investigation, which is concerned exclusively with trade, carried on in the pursuance of gainful economic exchange. A system of multilateral clearing may be superior to a system comprising a multitude of bilateral clearings ; but both are merely technical systems, and both are dependent for their success upon more fundamental factors. The maximisation of economic benefits to be derived from international trade can be facilitated but not automatically assured by any purely technical system.

How, then, would multilateral clearing—Pool Clearing—tend to affect those more fundamental real factors upon which so much depends ?

Let us say we make a start with this system and give every country the right to discharge all its cash obligations to the rest of the world simply by paying its own national currency into its National Clearing Fund. Every Clearing Fund would be entitled to receive any payment that arises out of international economic exchange, i.e. payments for foreign goods and services of all kinds, interest, dividend and amortisation payments on old and new foreign debts, etc. Only new capital movements would have to be dealt with specially, whether they arise out of commercial lending or a private flight of capital. They will be discussed later.

Whenever a National Clearing Fund receives payment from a resident at home who wishes to discharge a debt abroad, it notifies the National Clearing Fund in the payee's country, whereupon the latter makes payment to the payee. In this way, one might say, each country gives to each other country an overdraft facility for purposes of foreign payments. This might be a good way of getting world trade started again after the war when most countries will find themselves without any international means of payment. But it cannot be expected that any country would wish to give to the rest of the world an *unlimited* overdraft upon its own resources. How should these facilities be quantitatively determined?

There are two possibilities: each country might decide that it is prepared to allow its National Clearing Fund to run into debt with the internal money market up to a specified amount. After that amount has been reached, exporters would receive payment only to the extent that means of payment have been made available by importers. Or one might approach the problem from the other side: not from the angle of the granter of the overdraft, but from that of the recipient. Each country would be given a certain maximum limit beyond which the cash balance in its National Clearing Fund would not be allowed to rise. After that amount had been reached, the Clearing Funds in the rest of the world would take no further notice of notifications coming from the Clearing Fund of the "overdrawn" deficit country and refuse to make any further payments to their home exporters for goods delivered to that country.

These two methods of limitation come to the same in that they lead to a stoppage (or rationing) of deliveries to the overdrawn country. But their effect upon the rest of the world is quite different. Assume that there are six countries and each agrees to allow the five others jointly an overdraft not exceeding $10x$. If all countries but one then have a surplus of trade, the remaining one can go on accumulating deficits up to a total of $50x$, which may be grossly excessive. But if these six countries agree amongst themselves that no single country should be allowed to have a trade deficit exceeding $10x$, then the worst that might happen is that five countries become deficit countries each using its overdraft facilities to the full, and one country remains as the sole creditor on Pool Clearing account to the tune of $50x$.

Which of the two methods to choose involves a question of principle.

The first method of limitation makes it quite clear to each participant country what is its maximum stake in the Pool. The second method makes it quite clear to each participant what is its maximum indebtedness to the Pool. It should not be difficult to make the choice between them. The second method is the only workable one. If the first method were chosen, the maximum overdraft facility each country is to give would have to be kept so low that no one country, no matter how small, could ever become excessively indebted. This would rob the whole system of all its potentialities. If the second method is chosen, a maximum could be worked out for each country, adjusted to its normal trade turnover, and it would be left to each surplus country to see to it that its own surplus did not become excessive owing to a deficiency of purchases.

The actual determination of these upper limits should not provide undue difficulties. The leading nations of the world would have to agree on some definite formula (e.g. 30 per cent. of yearly exports as the maximum overdraft) and then invite all the other nations to join in on these terms. For a start, pre-war trade would have to be taken as a standard. If the same formula is applied to all countries, there will be no occasion for special bargaining and detailed negotiations. As the trade of any one country expands or contracts, so will its maximum deficit be allowed to increase or decrease.[1]

Assume, then, that appropriate limits have been fixed for the deficit any one country will be allowed to incur, and the system is put into operation. It will work smoothly as long as every nation manages to avoid exceeding the deficit limits. In this respect it would be analogous to a Gold Standard system, which works satisfactorily as long as deficit countries manage to balance their foreign exchange income and expenditure in such a way that their gold reserve remains intact. What forces, if any, are operative within the system to facilitate this task ?

The main force is the fact that the holding of surpluses becomes unprofitable and risky. The surplus, instead of being convertible into gold or interest-earning investments, is tied up in the Pool : it is a share in the Pool. And the Pool's assets are always the weakest currencies of the world : the currencies of the countries that have been unable to earn as much as they have spent.

In contradistinction to a bilateral set-up, however, Pool Clearing gives to each country the fullest opportunities to avoid becoming a surplus country : it can allow its importers to buy freely anywhere in the world, without regard to bilateral trade balances. If Argentina has made particularly large deliveries to Great Britain she can avoid becoming a surplus country by increasing her purchases (say) from the United States. This, of course, does not solve the problem of

[1] It is not suggested that there should be a *new* overdraft every year. The "maximum overdraft" might be considered as a *revolving* credit, the size of which fluctuates with the yearly volume of exports.

the British deficit, if there is one. But it solves Argentina's problem. The point is that each country can with the greatest ease and freedom avoid the accumulation of a surplus and reduce it once it has come into existence. If Argentina were tied down to spending all the proceeds of her exports to Britain on British goods, she might experience genuine difficulties in finding a sufficient amount of suitable and competitive goods on the British market. But if she is entirely free to spend her money wherever she likes, then any failure to spend on imports as much as has been earned on exports can only be a failure of effective demand within Argentina.

Such failures, of course, can occur, and are even likely to occur. Under the Gold Standard (or any other international monetary system based on free convertibility) they led to the general pursuance of a beggar-my-neighbour policy. Most countries during the 'thirties strove desperately to make up for the deficiencies of home investment by export surpluses ; those who succeeded reaped a double advantage : they increased home employment and accumulated either gold reserves at home or capital investments abroad. Under Pool Clearing a similar trend would undoubtedly assert itself, if the participating states failed to achieve a constant high level of employment at home. But it would take different forms. The surpluses arising out of current trade could not be converted into gold or interest-earning assets. They would be held as a precarious and barren investment. It might be, of course, that this deterrent against surpluses, or this incentive to import, would prove insufficient in a severe home unemployment crisis. But at least it is a force in the right direction which is absent from most other systems.

It might be said that any discouragement of surpluses will lead nations to ration their exports rather than expand their purchases. But this is unlikely. The temptation to aim at export surpluses is greatest when there is home unemployment. To restrict exports voluntarily just then would not recommend itself to any nation, and, if export surpluses are made unattractive by Pool Clearing, the chances are that a way out will be sought rather through speeding up imports by an expansionist internal policy (possibly with government help or on government account) than through slowing down exports. If this is so, the system would produce a strong inner tendency towards the expansion of world trade and would thereby stand in contrast to the system which prevailed before the war, when every international trade disequilibrium immediately set in motion restrictive forces.

The aim must be to achieve balance in the trade of every nation.[1] Such balance can be most easily achieved if potential surplus countries are discouraged from achieving a surplus. An attempt to throw the burden of adjustment primarily on the shoulders of the deficit countries (as in the past) is bound to fail, or at least to lead to

[1] Long-term lending will be dealt with below.

competitive trade restriction. A surplus in one country leads to deficits in other countries as light produces shadow. Since it is on the whole easier to spend additional amounts than to earn additional amounts, any new system of international trade and exchange should be so designed that all its inherent forces induce the surplus countries to dissipate their surplus, rather than inducing the deficit countries to make a (probably fruitless) attempt to balance their accounts either by forcing their goods upon an unwilling world or by restricting their purchases.

It may therefore not be rash to assume that Pool Clearing would exert a considerable influence upon the surplus countries to try and avoid all the risks involved in holding a share in the Pool by adopting any such measures as will increase the activities of their importers. But there are limits even here. It may well be that one or several countries are simply unable to offer, at the right price and at suitable delivery dates, a sufficient quantity of goods to pay for all their purchases. The evidence of this would be that their deficits showed a strong and apparently irresistible tendency to rise to their limits. It is in the interest of the rest of the world as well as of the countries concerned that the maximum limit should not be reached, because otherwise exports to the " overdrawn " countries might have to be rationed by direct intervention.[1]

In a situation of this kind there are, roughly speaking, three ways of escape that might recommend themselves :

(1) The deficit country might be given loan. Failing that, it might be found (2) that the best way to rectify the situation would be a devaluation of the deficit country's currency. If devaluation is inadvisable, (3) some fundamental rearrangements of the internal structure of production of some of the countries concerned might be called for.

(1) The granting of loans, of course, is always the easiest, though not always the most satisfactory way out. In the case of " backward areas " that stand in need of industrialisation, in all cases of genuine economic development, loans should be resorted to. But an attempt should be made to distinguish such cases clearly from others where the urge to borrow and the urge to lend arise merely out of the desire of creditor and debtor country alike to postpone the carrying out of necessary adjustments in their respective structures of production. Balance should be the watchword. International loans, which make possible a (justifiable) long-term lack of balance, should be treated as the exception. This might be considered too much to ask for. But however that may be, without adherence to some strict principles of this sort, no system, whatever its technical design, can do lasting service. No system can ever enable some countries to follow a permanent policy of buying from the rest of the world more than they

[1] In this case, the system, as far as the trade of the " overdrawn " country is concerned, would probably degenerate into some form of Bilateralism.

sell. Nor can it enable other countries to follow a permanent policy of selling more than they buy, and at the same time guarantee the creditor his money back, when he (or his country) is unwilling to accept it in the form of goods and services.

How, then, could the " exception ", i.e. capital movements for the purpose of ndustrialising backward areas, be worked into the system of Pool Clearing? It would be incompatible with the fundamental principles of the system, if Clearing Fund balances that have arisen out of past business were to be consolidated into long-term interest-bearing indebtedness. Credits should, on principle, be given only in connection with *new* deliveries to the deficit country. The difference between a conversion of existing clearing balances and making new deliveries on credit may appear slight. If a deficit country gets dangerously near its maximum deficit limit, does it not come to the same whether it transforms a part of the Clearing Fund balance into a bonded debt or obtains current imports on credit? Assume that Poland has incurred a large deficit; the Polish Government (or possibly even some private firm or institution) takes up a loan in U.S.A.; the American creditor pays dollars into the U.S. National Clearing Fund, and the Polish National Clearing Fund disburses a corresponding amount of zlotys to the Polish borrower. This would be a purely financial transaction, with the result that the United States could sell more without increasing the internal indebtedness of her National Clearing Fund (which represents her export surplus and her share in the Pool), and Poland could buy more without increasing the cash balance of her National Clearing Fund (which represents her import surplus and her indebtedness to the Pool). If this is admissible, then the principal feature of Pool Clearing is marred: the pressure which the system exerts upon potential surplus countries to dissipate their surpluses by increased purchases is relaxed.

There appear to be two ways in which this problem could be handled. (*a*) Let us assume that the rule is adopted that all " financial " lending operations under Pool Clearing are prohibited. If a country (say Poland) is in need of a larger amount of foreign goods and services than she can immediately pay for by means of her exports, she might obtain a foreign credit " in kind ", that is to say, she would ask some country or countries abroad to let her have certain specified deliveries on a deferred payment basis. Poland would then obtain goods without being obliged to make payment into its National Clearing Fund *at once*. Instead, she would issue a bond specifying the interest and amortisation payments that will be made later on. These latter payments, when they fall due, would of course take the form of money and would be made into the Polish National Clearing Fund, like any other international payment admitted under the scheme.

An arrangement of this sort would have the advantage of making the processes of international capital movements far more conscious and more easily recognisable than they have been hitherto. New borrowing would be for specified purposes only and take the form of the importation of goods (which might be producers' or consumers' goods) without immediate payment. Interest and amortisation charges would appear as a mortgage on the future overdraft facilities of the debtor country. The objection that might be raised is that in this way the lending operation itself (although not the return flow of interest and amortisation) would become bilateral in the sense that Poland, e.g., could not borrow in the United States and then spend the proceeds on additional imports from Britain. It is difficult to estimate the weight of this objection.

(*b*) Alternatively, the lending might take the form of an agreement between the U.S. Clearing Fund and the Polish Clearing Fund, whereunder additional imports made by Poland up to a specified amount are not to be paid for by the Polish importer through the Polish Fund, but by the American creditor through the American Fund. This arrangement would give Poland freedom to expend the loan money anywhere in the world. The objection that might be raised against it is that it would lend itself too easily to misuse. The weight of this objection, again, is difficult to estimate.

Whichever of these two alternatives is chosen, the effect will be that in a formal sense the debtor country will always be able to discharge the legal obligations which arise out of its indebtedness. Such payments will increase the cash balance in its National Clearing Fund and might raise it to the upper limit specified under the general scheme. They would act in the same way as payments made for additional current imports and create the same problems of adjustment. Similarly the National Clearing Fund of the creditor country would make corresponding payments to the creditor, thereby possibly increasing its own indebtedness to the internal money market—increasing, in other words, its share in the Pool. They would act in the same way as payments disbursed for additional current exports and create the same problems of adjustment. It would then be up to the creditor country (assuming that it is also a surplus country) to avoid becoming too large a holder in the Pool, by increasing its foreign purchases anywhere in the world.

This arrangement would show quite clearly the essential nature of international capital movements; they always are, and must be, an exchange (from the debtor country's point of view) of import surpluses to-day against export surpluses in the future. They are economically sound wherever there is reason to expect that the debtor country can increase its *future* capacity to export by increasing its *current* imports. If import surpluses are incurred without developing internal productivity and capacity to export, then existing maladjustments are not resolved and their solution is merely postponed. Escapist policies of this sort cannot be made impossible by any technical system; but it might be found that the arrangements suggested here will serve to clarify the position sufficiently to make their adoption less likely.

(2) We now come to the second way in which an adjustment might

be sought when a country appears to be unable to sell enough to pay for its purchases : devaluation. There is normally *some* level for each currency at which exports and imports will balance. But here again, " balance " is not everything, and equilibrium rates of exchange in many cases may mean disequilibrium somewhere else. They might, for instance, bring such a deterioration in the country's " terms of trade " as to be unbearable. But these are probably special cases. On the whole, a correct adjustment of exchange rates must be considered of the utmost importance. The principal criterion for correctness, and the object in view when changes are made, must be the establishment of " balance ", i.e. the avoidance of undue cash holdings or debits in the various National Clearing Funds.

In this connection it should be realised that, under Pool Clearing, the determination of the rates of exchange arises out of the co-operation between the different National Clearing Funds, and no one country is able to settle the rates of exchange of its own currency in opposition to the rest of the world, as has been possible hitherto. Clearing Fund *A* receives a certain amount of its own currency from an importer who has bought goods from an exporter in country *B*. Clearing Fund *A* thereupon advises Clearing Fund *B* of the payment received, and it is up to the latter to pay the exporter *at the ruling rates of exchange*. Thus, in order to alter the value of its currency, Clearing Fund *A* must first seek agreement with all other Clearing Funds, so that they will actually make their disbursements to their respective home exporters at the new rates.

Is it likely that such international agreement on exchange rates will be obtained ? This question sounds more formidable than it really is : under *any* system—even in the absence of an organised system, there must always be agreement between those who exchange currencies. Nobody proposes to leave these dealings entirely unorganised, and governments the world over are already accustomed to taking a hand in them. To get some working agreement to start with, therefore, will not be too difficult. Once a start has been made, it must be left to the actual development of trade (and lending) and to a process of trial and error to find those rates of exchange which most nearly establish an equilibrium position between the different countries. That this cannot be found, and that the necessary revisions which changing circumstances demand cannot be carried through, without some organised international effort, should by now be abundantly clear. There will be Exchange Equalisation Funds, no matter what system is finally adopted. And these institutions will get into touch with one another to settle policy on a wider or smaller scale. Pool Clearing does not *add* to the difficulties inherent, at the present stage of world political development, in any effort of international co-ordination. In fact, the Pool might be looked upon merely as an Exchange Equalisation Fund on a world scale. The inner mechanism of Pool Clearing, moreover, itself provides time and inducement for co-operation. It becomes unattractive, as we have seen, to accumulate surpluses ; but it becomes also unattractive to all participants to allow the deficit of any country to rise dangerously near its maximum limit. It is in the interest of both potential surplus countries and potential deficit countries to find an equilibrium level of exchange. Hitherto this was not the case. No matter how hard deficit countries might have been striving to reach equilibrium rates, the surplus countries found it useful to hang on to their surpluses and to answer the devaluation of other currencies by a devaluation of their own. Competitive devaluations, under Pool Clearing, would be completely pointless.

Assuming, then, that each country accepts the duty of keeping its own Clearing Fund in balance, and grants the right to every other country to choose any such means as will serve this purpose in their own case, there should be some international agency which will provide the machinery for reaching common decisions. The International Clearing Office, proposed above, might fulfil this function. But this would imply, of course, that its power and status would have to be raised far beyond that necessary for carrying out the purely formal " trustee " functions of " pooling ", as they have been described.

Our choice in this matter is not very wide : we can leave the conduct of economic affairs to a multitude of sectional interests (be they private or " national "), in which case we shall continue to be at the mercy of forces which have in the past landed us in a series of economic and political disasters ; or we can make an attempt at some form of world planning. Such an attempt may be successful, if the strongest nations take a determined lead and accept responsibility not only for the well-being of themselves but for that of the world as a whole.

All economic phenomena, in an era of quick transportation and intensive economic exchange, are interconnected. It would be foolish to propose that everything should be controlled centrally. But international trade is of fundamental importance as a strategic point of control. It might, therefore, be worth considering whether the time is not ripe for some international control in this field. The object of control, it is suggested, should be merely to achieve balance in the Clearing Funds of the various nations ; to avoid long-term cumulative surpluses and long-term cumulative deficits.

This, of course, would have far-reaching effects also upon purely internal policies in the different countries. Internal monetary policies, for instance, exert a strong effect upon external trade. A proposal, however, to subject them to international control would at the present stage appear wholly utopian. Thus each nation should be free to do internally whatever it pleases ; to aim at full employment with all its might ; to distribute its national income according to its own principles or lack of principles ; to control foreign exchange transactions or to leave them uncontrolled ; etc. Its responsibility to the rest of the world should end when it has balanced its Clearing Fund accounts. The primary responsibility should rest on the shoulders of surplus countries to spend as much as they have earned; and a secondary responsibility should rest on the shoulders of the deficit countries to make available, at the right prices, etc., a sufficient volume of goods so that all cash obligations can be discharged in kind. If an adjustment of the rates of exchange appears conducive to the discharge of these responsibilities, the International Clearing Office, as the responsible international agency, should seek to arrange it.

(3) In some cases the degree of devaluation necessary for "balance" may be such that vital interests of the country in question will be endangered. It is then that international loans might be considered, but they have been dealt with above. With the help of loans, or without it, the country would have to reorganise its industry, which would often mean a change over from home production to exports, or from one kind of export goods to another, or else a curtailment of its purchases. But a reorganisation within the deficit country alone might not solve the problem. An equal duty falls upon the surplus countries to reorganise in such a way that they can take more goods if more are offered. In such cases it may sometimes be unavoidable to adopt a certain degree of Bilateralism. A country that changes its structure of production so as to be able to export more must know the market whose requirements it is hoping to meet. And a country that makes similar internal changes so as to create additional import requirements must know its sources of supply.

Adjustments of this kind are admittedly difficult to effect, and even more difficult to enforce. But these difficulties again are not peculiar to Pool Clearing. They are inherent in any attempt at international economic co-operation, whether for the control of raw materials, cartels, transport, or anything else. It is often a matter merely of "Economic Intelligence", of the spread of reliable knowledge, and the compilation of reliable statistics of productive capacities and human needs. A clear recognition of the necessity of balance, together with a system of exchange which makes surpluses unattractive, might exert pressure in the right direction. But it must be emphasised that no system, whatever its technical form, is likely to endure unless the great cyclical waves of unemployment, which have been the greatest single factor of disruption in the past, can be avoided in the future.

In the beginning of this essay we have accepted, by way of assumption, that certain advantages could be gained by employing the clearing principle for international trade. The course of our discussion should have made it plain that this assumption is not entirely unjustified.[1] In comparison with free international convertibility of currencies, Pool Clearing offers at least one outstanding advantage: that its inner mechanism tends to overcome temporary disequilibrium situations in international exchange by expansion instead of restric-

[1] For a further discussion of the clearing principle see: E. F. Schumacher, "United States Foreign Trade Policy," *Agenda*, Vol. I, No. 3, July, 1942.

tion. The buyer is given the first move in the game, on the self-evident theory that one country's imports are another country's exports and that, if only demand can be liberated, supply will largely take care of itself. Thus the main burden of adjustment is placed on the surplus countries, and forces are brought into play to make them spend their surpluses, thereby enabling the deficit countries to get rid of their deficits without restricting their purchases. The overdraft facilities to be granted to each country are an expression of the determination to give the buyer the benefit of the doubt, and a means of getting international trade started again after the war, in spite of the widespread shortage of international cash.

This inner expansionist force of the system is its most important feature. The isolation of trade movements from speculative capital movements, which this system brings about, can be attained also by other means. So can the medium-term stability of exchange rates, or the minimum degree of international co-operation which is necessary in this field whatever its technical organisation. The same applies to the fact that Pool Clearing would make the international payments position of each country "transparent" by summing up its vital aspect in *one* figure, the debit or credit balance of the National Clearing Fund. All this can be attained by a variety of means, not necessarily those of Pool Clearing. But can we get this expansionist element into the international system by other means? And is this element something worth striving for? These are the questions which grow out of this essay and towards the solution of which the above is hoped to be a contribution.

Whether the efforts required for the establishment of such a system are worth while, and whether the risks inherent in any new departures can prudently be taken—that can be decided only by considering the available alternatives. At least two alternatives are at present clearly visible: a continuation of the pre-war trend which worked towards a splitting up of the world trading system into innumerable uncoordinated bilateral systems. This prospect needs only to be stated to reduce itself to absurdity. Or: a continuation of the war-time trend towards the formation of regional economic blocs, within which, in all probability, some form of multilateral clearing would ultimately establish itself.

Economic regionalism might be considered superior to the anarchy of rigid Bilateralism. But it surely cannot be the last word in post-war economic organisation. The above attempts to show just one way of driving a wedge into the solid block of resistance against economic planning on a world-scale. Other ways, no doubt, exist. They should be fully described and fully discussed. Some world-embracing scheme, conceived with realism and daring, must be developed to meet the challenge of Bilateralism as well as that of Economic Regionalism. And such a scheme, it is felt, should above all possess an inherent tendency towards expansion.

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