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Postwar Bilateral Payments Agreements

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This is the fourth number in the series called Princeton Studies in International Finance, published from time to time under the sponsorship of the International Finance Section of the Department of Economics and Sociology in Princeton University. In the past, Princeton University Press has published and distributed these Studies on behalf of the Section. The Press will continue to distribute the Studies issued prior to this one, but this and future numbers will be published and distributed directly by the Section. As an experiment, the Section will provide single copies of the Studies it distributes to United States residents on the basis of specific requests accompanied by 25 cents to cover mailing and packaging costs. No charge will be made for single copies requested by residents of foreign countries.

This monograph was prepared while Dr. Merlyn N. Trued, now on the staff of the Federal Reserve Bank of New York, was completing his doctoral work and teaching at the University of Virginia. Raymond F. Mikesell is Professor of Economics at the University of Virginia. The authors of course do not pretend to speak for the institutions with which they are or have been associated.

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Gardner Patterson, *Director*
International Finance Section

Princeton University
January 1955

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I. Introduction[1]

The bilateral payments agreement was developed in the 1930's partly as a means of enabling creditor countries to collect from debtor countries unwilling or unable to pay in free exchange, and partly to finance bilateral trade where one country or both employed exchange controls. The essential element in these agreements was the control over the use of national currency balances in the hands of nonresidents. This control included limitations on the transferability of the balances to third countries, restrictions on the purposes for which payments could be made with the balances, and definition of the transactions under which the balances could be credited.

A bilateral payments agreement may be defined as an agreement which establishes a general method of financing trade between two countries, giving rise to credits which are available for use in making payments for a wide range of imports from the other country or for other specified purposes. The establishment of an account simply for measuring the progress of an agreement to exchange a given quantity of one commodity for a given quantity

[1] NOTE ON SOURCE MATERIAL

This study is based in large measure on information obtained from the basic payments agreement documents, but it appeared neither feasible nor desirable to cite here the several hundred documents used. Many of them were made available through the courtesy of the International Monetary Fund. Much information was also gained from conversations, especially with members of the staff of the International Monetary Fund engaged in the study of various restrictions on international trade and payments. Our debt to them is very great, but it did not seem appropriate to attempt to attribute specific statements to specific individuals. Many of the statements of fact therefore are unsupported by references to sources.

A large number of easily accessible publications have also been used, the more important being: *Aussenhandelsdienst* (Cologne); *Bilateral Agreements in International Trade* (mimeo.), Washington, D.C., U.S. Department of State, Office of Intelligence Research, April 1954; *Board of Trade Journal* (London); *Commercial Trade News* (London); *Conjuntura Econômica* (Rio de Janeiro); *Far East Trader* (San Francisco); *Fortnightly Review*, London, Bank of London and South America; *Financial Times* (London); *Foreign Commerce Weekly*, Washington, D.C., U.S. Department of Commerce; *Handelsblatt* (Dusseldorf); *International Trade News Bulletin*, Geneva, General Agreement on Tariffs and Trade; *International Financial News Survey*, Washington, D.C., International Monetary Fund; *Journal of Commerce* (New York); *Le Monde* (Paris); *Le Moniteur Officiel* (Paris); *Monthly Bulletin of the British Chamber of Commerce in Brazil* (Rio de Janeiro; *Neue Zürcher Zeitung* (Zurich); *New York Herald Tribune; New York Times; Oriental Economist* (Tokyo); *Review of the River Plate* (Buenos Aires); and *Wall Street Journal* (New York).

of another is excluded from our definition. Such arrangements, even if they cover several commodities, represent barter transactions and involve no foreign exchange payments.

After the end of World War II, the bilateral payments agreement, differing in important respects from the type negotiated before the war,[2] became the basic instrument for the financing of trade among most of the countries of the nondollar world.[3] The postwar agreements were regarded by most signatories as *temporary* devices for *liberating* trade and payments from the severe restrictions imposed on transactions in convertible exchange necessitated by economic conditions immediately following the war. These agreements made it possible for individual countries to purchase foreign goods with their own currencies without risk of depreciation or loss of hard-currency reserves. They also made it possible for them to free at least some of the balances of their currencies held by foreigners without a loss of free exchange.

A large number of these agreements were first negotiated in 1944 and 1945, a time when the Bretton Woods agreements were under consideration. Many of the early bilateral payments agreements therefore contained clauses providing for the termination of any provisions which might subsequently be found inconsistent with obligations assumed by the signers as members of the International Monetary Fund. Thus, the features of the pacts which involved restrictions on current transactions were regarded as transitional arrangements to be swept away with the reestablishment of the world-wide multilateral payments system envisaged by the Articles of Agreement of the Fund.

But these early expectations were not to be realized. The fail-

[2] The agreements of the 1930's were principally between free-exchange and exchange-control countries; only a handful of such agreements exist today. Moreover, before the war, trade between exchange-control countries was frequently conducted under bilateral *clearing* agreements. Although many of the postwar agreements employ one or more clearing accounts for recording credits and debits arising out of trade, they differ from the prewar clearing agreements in that they commonly employ "swing" credits which enable exporters in the creditor country to receive payment without having to wait for importers in the debtor country to make payment into the account. Even where definite swing credits are not employed, in practice the accounts may be unbalanced between settlement dates.

[3] See R. F. Mikesell, *Foreign Exchange in the Postwar World*, New York, Twentieth Century Fund, 1954, Chaps. 1 and 2.

ure of the British convertibility experiment in 1947 encouraged the conviction that the postwar transitional period, during which members of the Fund were permitted to employ restrictive arrangements, would be of indefinite duration. And the number of bilateral payments agreements, which totalled some 200 in 1947, nearly doubled in the following three years until they covered virtually the entire nondollar world. And so it remains at the time of writing.

It is important to note that this growth in the network of payments agreements did not mean that trade was therefore becoming increasingly more bilateral in character. On the contrary, the absence of a bilateral payments agreement between two nondollar countries frequently meant that trade between them took place only under rigidly balancing barter arrangements, if at all. Inasmuch as nearly all nondollar countries had adopted a policy of not making payments in convertible currencies except in trade with the dollar area or for the purchase of certain "scarce" commodities, a bilateral payments agreement was necessary for the establishment of a *general* means of financing trade between nondollar countries.[4]

It is, of course, true that the early postwar payments agreements generally sought to achieve a bilateral trade balance between the partners or their currency areas. They were therefore accompanied by trade-quota or bulk-purchase agreements which involved a rather high degree of control over the course of trade. Excessive debtor positions were frequently liquidated after a short time in gold or dollars, and most countries, anxious to conserve their free-exchange holdings for imports from the dollar area, were therefore reluctant to exceed their credit margins or to permit balances of their own currencies to be transferred to third countries. However, this situation has changed greatly in recent years. Most nondollar trade, although still conducted under bi-

[4] British bilateral agreements set forth the conditions for the transfer of sterling between nonsterling countries generally. In some cases, however, trade between nonsterling countries was conducted through the use of inconvertible sterling and without a formal payments agreement, but in such cases it was necessary for the countries concerned to have an arrangement with Britain governing the conditions under which sterling might be used; these countries were listed as "unclassified countries" by British exchange regulations.

lateral payments agreements, is not bilateral in character. Transferability of balances is permitted over a wide area, and the greater part of nondollar trade is no longer governed by trade-quota or bulk-purchase agreements. Nevertheless, the bilateral payments agreements serve to limit the area of the transferability of the balances arising out of international transactions and frequently limit the purposes for which they may be used.

Before proceeding to a detailed examination of the postwar agreements, a brief description of the major types of provisions to be found in bilateral payments agreements and of the major types of agreements seems in order.

Major Provisions of the Agreements

TENURE PROVISIONS. Most payments agreements provide either for a definite period during which the pact is valid or for annual tacit renewal. Some agreements have an indefinite life but are subject to termination upon reasonable notice by either party. The tendency has been for the payments arrangements to continue in force without major change for several years. On the other hand, trade-quota agreements, where they exist, are usually renegotiated every year to take account of changing import needs and export availabilities, as well as of the bilateral payments position as reflected in the account.

THE ACCOUNTS. All payments agreements designate one or two units of account and prescribe the method of accounting for debit and credit transactions arising under the agreement. Under some —for example, the sterling agreements—the method of accounting differs little from that in the financing of trade with sterling or dollars before World War II, except that the sterling cannot be transferred to a resident of the dollar area. Most of the payments conventions among the Western European countries provide for financing in the currency of either partner and the accounts are held in the form of bank balances owned by banks or firms in the partner country. Under agreements which permit accounts to be maintained in commercial banks, periodic clearing between the commercial banks and the central bank of each country is usually required in order to determine the net position of the partner countries. In other cases, the accounts are centralized in one or both of the central banks of the partner countries and the accounting units may be either one or both of the national currencies or, in some cases, a third currency, usually the dollar or sterling. Where more than one currency is employed as the unit of account, the agreement establishes the exchange rate between them.

CREDIT PROVISIONS. Except for pure barter transactions with no time lag between deliveries, all international trade transactions involve credit. Most bilateral payments agreements provide for reciprocal credits, established in different ways depending upon the accounting arrangements. A typical "swing" credit allows each partner to run a deficit in the account up to a certain limit, beyond which it must make a settlement. In some agreements, such as those between members of the European Payments Union (EPU), periodic settlement dates take the place of definite swing credits. In many of the sterling agreements, the credit is unilateral in favor of Britain inasmuch as the partner countries simply agree to hold an indefinite amount of sterling.

SETTLEMENT PROVISIONS. Problems of settlement arise both during the life of an agreement and at its termination. Some agreements provide for the settlement of balances in *excess of swing credits* during the life of the agreement only in goods, while others provide for settlement in gold, in third currencies, or, as in the case of the agreements between members of the EPU, through a clearing union. The settlement of final balances is frequently left to mutual agreement at the termination of the convention or is by payment in gold over a period of time in the event that the partners cannot agree.

TRADE PROVISIONS. Sterling agreements and those between EPU members provide for multilateral settlements over a wide area and a method for financing virtually all transactions. Although individual countries may employ quantitative restrictions on certain imports, such agreements, in general, are not discriminatory as between members of the group and do not aim at a bilateral balance of trade between any two particular countries. Most other payments agreements, however, are selective as to the types of transactions and kinds of goods and services that may be financed under the arrangement. Generally the payments agreement itself excludes capital transactions but does not deal with the specific goods and services that may be financed; rather it makes reference to the trade agreement, a separate pact, which accompanies the payments agreement and treats more or less in detail the goods and services to be financed. The usual means of seeking to balance trade between partners is to establish, in the trade pact, lists of commodities which each country is interested in buying from the other, together with the import quotas which each country agrees to set for each of the commodities listed. Except where debt service or other invisible payments are involved, the sums of the import quotas establish a target trade balance for the two countries over the life of the trade pact. Such conventions, often called trade-quota agreements, are usually revised every year.

TRANSFERABILITY OF BALANCES. Some agreements permit balances in the accounts to be transferred to third countries; some also authorize transfers of balances held by third countries in one of the partner countries to be credited to the bilateral accounts. Such transfers may be permitted automatically or only by mutual consent.

Major Types of Agreements

Bilateral payments agreements may be classified in a number of ways inasmuch as their provisions differ widely as to the nature of the accounts, the credit arrangements, the settlement of balances, the means of limiting the surpluses or deficits, the transferability of balances, and so on. The most significant classification would seem to be with reference to the flexibility of the payments arrangements and the degree to which they permit an advance toward free-exchange conditions. From this point of view, bilateral payments agreements may be divided into three types: bilateral offset agreements, exchange settlement agreements, and automatic transferability agreements.

Bilateral offset agreements make no provision for the settlement in gold or third currencies of balances that exceed the swing credit limit set in the agreement: any such balance in the accounts must be settled by the export of goods from the debtor country. Similarly, any balance that may exist upon expiration of these agreements is settled only in goods. Bilateral offset agreements also frequently contemplate strict supervision of trade and shortterm bilateral balancing of goods and services. Moreover, they usually specify that reexported goods are not acceptable accounting items.

Bilateral offset agreements are accordingly the least flexible of the payments arrangements and are distinguished from barter transactions only by the fact that they permit trade in a wide variety of items to be financed through the accounts and allow a time lag between deliveries. As a rule, records are maintained in central clearing accounts established in one or both of the national currencies of the partners or in a third currency, in practice usually the dollar.

Exchange settlement agreements make provision for the settlement of balances beyond the swing credit in gold, convertible currencies, or in mutually agreed third currencies which are inconvertible. Provision is frequently made for the transferability of balances in the accounts to third countries, provided all three countries agree to such transfers. Generally, all transactions must be recorded in the central account or accounts which the partners agree to maintain in accordance with the terms of the agreement.[5]

Automatic transferability agreements provide for automatic transfers of balances to certain third countries or to a clearing union, as in the case of the European Payments Union. In addition, they sometimes permit payments between residents of the partner countries in designated third currencies, and, in some cases, provision is made for the automatic settlement of balances in third currencies. In practice, arrangements of the automatic transferability type permit banks and firms to hold balances in the partner country and provide for a considerable degree of freedom in foreign exchange operations by the authorized banks.

Automatic transferability agreements such as those between members of the EPU and those negotiated by Britain with nearly all nondollar countries are usually not accompanied by trade agreements which aim at bilaterally balanced trade. Nor do they

[5] Under a number of these agreements, some countries, as a domestic matter, permit transactions to be financed with currency balances held by their commercial banks and firms in the commercial banks of the other country. In such cases, however, foreign balances above a certain level must be turned over periodically to the central bank so that the bilateral position between the partner countries can readily be determined. These various arrangements are discussed in Section III.

as a rule provide for definite swing credits or place limits on the amounts of the transferable currencies which the partners may hold. The fact that the balances are transferable makes it easier for countries to avoid accumulating large inconvertible balances. But the country whose currency is transferable must be in approximate balance with the transferable group as a whole or its currency is likely to accumulate in large quantities in the accounts of the strongest members of the system within which it is transferable. It was for this reason that strong-currency countries like Belgium and Switzerland chose not to be members of the sterling transferable account system after August 1947. However, after the establishment of the EPU, sterling balances became available for EPU settlements and hence generally acceptable to Belgium and Switzerland, as well as to all other Union members.[6]

While all three types of payments agreements are in operation today, since March 1954 over two-thirds of the world's nondollar trade has been financed under the automatic transferability type of agreement. The bulk of the remaining nondollar trade among free-world countries is conducted under exchange settlement agreements which provide for the settlement of balances in excess of permitted swing credits in gold, United States dollars, or in mutually agreed third currencies. Agreements of the bilateral offset type, which approach more closely the conditions of barter trade, are largely confined to arrangements with countries in the Soviet orbit, although Western European nations have negotiated a few such agreements with Latin American countries. Table I classifies the 388 bilateral payments agreements known to the authors to exist as of June 1954 according to types of agreement and major geographical areas.

[6] Before March 1954, sterling was automatically transferable between bilateral-account countries only when they were members of the European Payments Union. Since then Britain has placed virtually no restrictions on sterling transfers among nondollar countries.

TABLE I

Number of Bilateral Payments Agreements by Types of Settlement and by Major Areas

(As of mid-1954)

	Automatic transferability	*Exchange settlement*	*Bilateral offset agreements*	*Other*[a]
Sterling area	43	0	0	0
Continental OEEC with:				
Continental OEEC	78	0	0	0
Spain	0	8	2	3
Latin America	1	35	11	1
Far East	1	6	0	0
Middle East	1	14	4	5
Eastern Europe[b]	0	31	54	4
Spain with:				
Latin America	0	5	3	0
Middle East	0	1	0	0
Latin America with:				
Latin America	0	17	0	0
Far East	0	2	0	0
Middle East	0	2	0	0
Eastern Europe	0	12	5	3
Far East with:				
Far East	0	7	0	0
Middle East	0	0	1	0
Eastern Europe	0	1	0	0
Middle East with:				
Middle East	0	1	2	2
Eastern Europe	0	5	7	2
Eastern Europe with:				
Eastern Europe[c]	0	0	8	0
Total	124	147	97	20

[a] Information necessary for classification not available.

[b] Includes countries of the Soviet orbit, plus Finland and Yugoslavia.

[c] Excludes intra-Soviet orbit agreements.

Source: Based on information obtained from the sources indicated in footnote 1, page 1, of this study. It should be noted that some agreements may in practice vary from the classification given here because of changes through secret protocols, or because of amendments not made public.