ECONOMICS OF PLANNING
Vol. 7, No. 2, 1967
Printed in Norway

A multilateral trade clearing agency[1]

Ragnar Frisch
University of Oslo, Norway

World trade is a vital condition for world economic and social progress. It is a necessary condition, a *conditio sine qua non* for progress at the stage in the history of the human race on which we are now embarking.

It is, of course, in no way a sufficient condition. But that is an other story. In the present paper I am concerned only with world trade as a necessary condition for world economic and social progress.

What can we do to facilitate and stimulate world trade in a truly effective way?

Here I must make a confession of faith. It is my deepest conviction that we would start on the wrong road if we aimed at the creation of *blocks,* whether they be small or large. Too much of the discussion today has centered around questions like this: Should we aim at a Nordic block? Or at the perfection of the EFTA block? Or should we aim at a Commonwealth–EFTA block? Or at a still larger Commonwealth–EFTA–United States block?

When thinking of world economic and social progress we must free our minds completely of the concept of blocks, whether they be small or large and whether they be economic, political or military. World economic and social progress depends on the organization of something which is of a *purely international trade nature* and which in principle may – if they so desire – be adhered to by *any* country or group of countries regardless of internal economic system or race or creed. And the adherence of any country or group of countries that wants to join, must

[1] This article is a slightly revised version of a paper prepared for the All Nations Trade and Economic Discussion Conference under the title of "Towards a World Economic Conference" initiated by The Forward Britain Movement and held in London 11–15 March 1963. It was presented in the Norwegian journal *Statsøkonomisk tidsskrift,* No. 1, 1963.

be possible by a *fairly simple administrative procedure* without such high strung political negotiations as we have witnessed in recent years concerning the British application for membership in the EEC.

This something must not be concentrated simply on the reduction of tariff-rates and on similar aspects of international trade. Discussion has centered too much on the reduction of tariff rates. The monomaniac concentration on tariff-rates as *the* problem of world trade has made us forget another aspect of the problem which is in fact much more important, namely the *multilateral balancing* of world trade.

To illustrate the essence of this aspect of the problem we may think of the tailor and the shoemaker who were standing looking at each other with sorrowful faces. The sorrow stemmed from the fact that the tailor did not *dare* to order the shoes he needed because he was not sure that he would be able to sell any suit to the shoemaker, while the shoemaker did not *dare* to order the suit he needed because he was not sure that he would be able to sell any shoes to the tailor. If we include also the baker, the fisherman and a few others in the picture we have a good illustration of what is meant by the multilateral balancing problem, and in particular we get an illustration of the need for a system which can *assure* everybody that he is taking part in a game where a multilateral balancing is *automatically provided for.*

Without an arrangement which will assure *automatic* balancing in international trade we shall never be able radically to eliminate the strangulation effect which is produced because each country separately has to protect its balance of payments. Under certain circumstances these separate actions may even create a general scramble for liquidity which causes a substantial part of human and physical resources to lay idle. This is a particularly important aspect of international trade at a moment where there is a threat of world depression.

To bring out forcefully the distinction between bilateral and multilateral balancing let me quote an illustration which I believe I have from Keynes (without, however, being able to guarantee that I have not modified it a bit in the course of time). It is the illustration of the eremite and the c'rcuit. If the eremite is struck by lightning, this is a deplorable happening for him but it does not concern anybody else. On the other hand if there is a circuit of persons, the first delivering goods to the second, the second to the third and so on until person No. n who delivers goods to No. 1 so that everybody gets what he needs and everybody is able to pay for it, it would be a disaster to everybody if any single person in the circuit is struck by lightning.

The balancing of receipts and deliveries in the circuit can not be achieved by any sort of bilateral arrangement. The balancing *has to be* multilateral, otherwise the whole process would stop. In the case where the linkage between the persons is not strictly of the circuit type but consists of many crossroads and partial loops between the persons, the enforcement of the rule that all balancing should be of bilateral type may not stop *all* activity but it would seriously *reduce* the total activity.

A monetary system assures multilaterality. And it does so in an all the more perfect way the more *generally acceptable* the money is, as among individuals and as among countries. But the monetary system does not assure automatic balancing and thus does *not* solve the paradox of the tailor and the shoemaker. International credit arrangements, with whatever ingenuity they are construed, can do nothing more than to *postpone* the final balancing problem.

Bilateral trade agreements of the barter type does solve the paradox of the tailor and the shoemaker – the problem of the scramble for liquidity – but it does *not* solve the problem of multilaterality.

This remark contains no criticism of bilateral barter arrangements *per se*. There are situations where the liquidity problem may cause more trouble than the multilaterality problem, and where bilateral loops may therefore have some good effects. Multilateral barter arrangements are, of course, too difficult to be concluded just by talking. For this an *operational machinery* is needed. We as economists and social engineers should provide the politicians with a proposal for such a machinery.

In doing this we must think along bold new lines. We must not turn around and around in the old monetary way of thinking. Not least from the viewpoint of the developing countries has bold new thinking become a necessity.[1]

What we need is a trade clearing agency that can solve *at the same time* the multilaterality problem and the tailor – shoemaker paradox. We must assure everybody of an *automatic* balancing.

---

[1] Among the many statements that could be quoted in this connection I will give only one taken from the leading article by Dr. Janvid Flere in the *Review of International Affairs* XIV, Belgrade, Yugoslavia, (5 February 1963). He says: "... in the economic field, too, it will no longer do to seek partial and consequently inadequate solutions (as was the case in the last decade), but ... efforts should and must be made to consider more far-reaching and radical solutions, which will make it really possible to promote international economic co-operation. Accordingly, in preparing the UN Economic Conference, it is not enough merely to analyze the already well-known and accepted problems and proposals. A great deal more than this is needed today; it is necessary to approach the present problems more boldly ..."

The basic ideas of such an agency I suggested several years ago.[1] In an address 17 July 1962 in London at the Britain–Commonwealth–EFTA Conference organized by The Forward Britain Movement I reverted to the problem.[2] In the international trade confusion of the world today it seems that time has come to bring the multilateral trade clearing agency to the blue-print stage.

There are as I see it nine principles on which a multilateral trade clearing agency must be built.

First principle. The agency must be built on the existence of national states that retain a considerable degree of sovereignty so far as the internal organization of their economics and political systems is concerned. It is simply out of the question that the *big* powers such as for instance the United States or the Soviet Union can be persuaded to accept anything else. And it is immoral to use the steam roller over the smaller countries so as to make *them* fit into the pattern of big antagonistic blocks.

Second principle. Each country must be given an opportunity to voice its own desires regarding its own economic targets, such as different types of investments to be made, different directions in which to push its exports, and so on. Otherwise each nation will feel that its hands have been tied in an unbearable manner and that it has been completely deprived of its economic manouvrability.

Third principle. This is the principle of consistency. If each of these independently worked out systems of economic targets and plans were to be carried out, they might, and in general will, turn out to be completely *inconsistent.* They will work counter to each other. It is precisely this inconsistency that produces the basic difficulty in matters of international trade. So in some way the different systems of targets and plans have to be made consistent. And in the manner of making them consistent is precisely where the multilateral trade clearing agency has a role to play.

Fourth principle. Once an overall consistent and in some sense optimal solution is worked out through the multilateral trade clearing agency in step by step negotiations between the agency and the countries con-

[1] Ragnar Frisch: "On the Need for Forecasting a Multilateral Balance of Payments." *American Economic Review* XXXVII (September, 1947) pp. 535–551. Reprinted (somewhat shortened) in *Foreign Trade and Finance*, ed. William Allen, C. L. Allen. New York: The Macmillan Company, 1959 pp. 410–425.

Ragnar Frisch: "The problem of Multicompensatory Trade. Outline of a System of Multicompensatory Trade." *The Review of Economics and Statistics* XXX (November, 1948).

[2] The address is printed in *Report of the Britain–Commonwealth–EFTA Conference held at House of Commons*, London, July 16–19, 1962.

cerned, and finally agreed upon, the national states must take on a definite commitment to act according to the new targets. Such a national commitment can, of course, not go beyond the jurisdiction which the state has over its citizens according to the political system the nation has chosen to work with. But within this jurisdiction each nation must accept the commitment that is implied in the universal optimal targets.

Fifth principles. The targets must be formulated in volume figures, not in value figures. You may think that the very concept of volume figures does not exist in a world where there are millions and billions of different commodities and services each with definite specifications. But in fact the concept of volume figures does exist. It can be made tangible through the medium of value figures expressed in base year prices. It is with these volume figures that the multilateral trade clearing agency will have to work.

Sixth principle. The solution must be formulated in terms of definite time periods. Whether these time periods ought to be years or quarters or months is a practical question.

These periods must be looked upon from two different angles.

Each period will be a *contracting* period, that is a definite period when the national commitments are made. But each period must also be looked upon as a *settlement* period, that is a period when the agreed upon international trade transactions are to be carried out.

In each contracting period – i.e. each point of time when commitments are made – one must not only think of the actual trade transactions that are to take place in this particular period, but one must also think of the transactions that will follow in the subsequent settlement periods over a foreseable future as a consequence of the commitments made in the particular contracting period in question. In other words any national commitment will have to be concerned not only with transactions in the contracting period but also with the ensuing transactions in a certain number of settlement periods in the foreseable future.

Seventh principle. The optimal targets for international trade transactions in each of the settlement periods in the foreseable future must not be conceived of as something that should be balanced in *each* settlement period taken *separately*. This would mean that the total creditor positions of each country, or if you wish, its total foreign indebtedness, were at all times to remain constant. This would petrify the whole system and take away the driving force for progress which consists in the possibility that during certain periods some countries may have a surplus of commodities and services (measured in real volume terms) that can be used to good advantage by other countries, while in other periods the situation may be reversed so that now there are some other countries that work with an international surplus.

Therefore the balancing of the optimal targets will have to be conceived of as a balancing in the long run. And by long run I mean a run that is somewhat shorter than the run in which we will (according to Keynes) all be dead.

This dynamic long run concept of balancing the volume targets to which the nations would have committed themselves, will implicitely, by the mere rules of the balancing process, solve automatically the problem of redemption of foreign loans and the planning of foreign aid to developing countries. Gifts from some countries to others will automatically be taken care of simply by including these gifts as specific items in the balancing accounts. The size of these specific items will be a good measure of the willingness of some countries to help others.

Eighth principle. This concerns the role of exchange rates. In the clearing and balancing of volume figures the question of exchange rates will play a very incidental role. Since a definite system of national commitments is established *at a given date,* that is in a given contracting period, one will have done away with the excessive element of speculation that is now involved in the future course of exchange rates and in vicissitudes of international capital movements. Existing exchange rates will only come into the picture as a sort of calculation key by which to make comparable the figures that are expressed in different monetary units. It is simply a device which will enable the multilateral trade clearing agency to perform its calculations.

Ninth principle. This is what may be called the principle of openness and of partial trade.

In the world of realities we must recognize that it is impossible to establish such a multilateral trade agency in one stroke and in its full dress. We have to proceed bit by bit. But these bits must be of a particular sort.

In the first place the agency must be open to any country that chooses to adhere, as I have already mentioned. But in practice we might perhaps start by concentrating our efforts on some particular group of countries which we know are able to cooperate, such as the EFTA countries and the Commonwealth countries and some of the underdeveloped countries.

In the second place each adhering country must be free to let, if it so desires, only a part – small or large – of its international trade be cleared through the agency. This part is the multicompensatory – or shorter the compensatory – part of its international trade. Each country must be left free to handle the rest of its international trade in any other way which it may see fit.

By leaving each country completely free to determine itself how much of its international trade it wants to see cleared through the agency, the whole arrangement will appear as very similar to something which is well known and has been practised for a long time, namely the bilateral trade agreements. The only difference is that the trade negociations are now imbedded in a *multilateral* setting. The enormous gains to be obtained by multilaterality I have discussed above.

By adapting the principle of openess and partial trade and thus giving the arrangement a form which in reality is only an *extension* and *further elaboration* of something that is well known and has been practised for a long time, there ought to be a very fair chance of making the arrangement successfully applicable in practice. The principle of openness and partial trade may therefore well deserve to be called also the principle of practical applicability.

But this being said it must be clearly recognized that the possibility of fitting the items together in such a way as to make the compensatory trade balance *at a high level,* will be all the better the larger and more diversified parts of international trade the countries want to pass through the multicompensatory arrangement.

In a sense it is therefore regrettable that we have to begin by adapting the principle of openness and partial trade. However, it is very realistic, I believe, to hope that if we could only make a beginning, it would turn out and become more and more clear to everybody that a truly multilateral arrangement as the one here suggested will be to the advantage of everybody. This multilateral clearing will therefore, in all probability, little by little – and all by itself – come to embrace a constantly growing part of international trade.

The organizational set up must be worked out with careful consideration of all practical details. The following is a sketch of what I believe at this writing might be a practical possibility.

In each period each member state of the clearing organization sends to the clearings' Commission a list of commodities which it would like to see cleared – exported or imported – in each of a number of following periods. The commodities are to be classified according to a standard nomenclature (for instance The Brussels Nomenclature). Each export item is accompanied by an export price below which the country is not willing to sell. And each import item is accompanied by an import price above which the country is not willing to buy. All prices are to be made internationally comparable by a conventional procedure.

In special cases it might be necessary to add – for any export or import item – also a *priority number* regarding trading partner. First priority indicated by 100 per cent, second priority indicated by some lower number and third priority by a still lower number; the second and third priority numbers being chosen by the country in question.

Such priority numbers may be motivated by strictly economic reasons, for instance because specific types of machinery or specific types of consumer goods are available in special countries.

But certain political reasons may also be involved in the fixation of priority numbers. One country may for instance be unwilling to send strategic commodities to some special country or group of countries. If so, the priority numbers in question would have to be put equal to zero.

It would be no business of the clearing organization to form an opinion about why these political considerations have come into the picture and still less would it be the business of the clearing organization to condemn or applaud such political motivations. The clearing organization is to operate as a *strictly economic* organization. But it must be clearly recognized that the more priority numbers *zero* are introduced, the more one will restrict the possibility of the clearing Commission to fit export desiderata and import desiderata together in such a way as to reach a *high* total clearing volume.

The Commission would have to act in a twofold way.

In the first place it would have to compute by its computing experts, using electronic data processing machines, how the clearing can be carried out in a way that assures *balancing* for all countries and produces the *optimal* combination of exports and imports and trading partners, i.e. the best combination that can possibly be reached when the clearing is to be balanced.

What is to be defined as optimal? It seems to me that a simple and just answer would be to say that optimal is a combination of exports and imports and trading partners as will make the following expression the largest possible: For each country the final balancing will be characterized by export and import volumes which may not be exactly what these countries specified as their desiderata, but will be something which the clearing Commission has strived to make as closely equal to the countries desiderate as possible. Multiply these volumes by clearing prices determined more or less by classical "supply and demand curve crossing" when each nation is considered as an "individual" on the supply side and on the demand side (or perhaps multiply by the prices expressed by the country itself). In any case the prices are internationally comparable. Also multiply by the expressed priorities. The sum of all these products may be assumed to be what the country in question would like to see large.[1] If it prefers a modification in this formulation, this might be considered. For all countries taking part in the clearing these national formulations may be rendered comparable by multiplication with the *population size*. This would attribute great weight to the developing countries, and would be an act which demonstrates that the highly developed countries want to pay more than lip service to be developing countries.

In the second place the Commission would have to act more or less as a trade delegation of the classical type, entering into negotiations with each individual country to see if there are particular *changes* in the country's expressed volume desiderata which it might be willing to accept in order to bring the total figure which defines the overall-clearing optimum up to a still higher level. For these negotiations each member country would undoubtedly want to have its own trade delegation work more or less permanently at the site of the Commission.

Through such negotiations improvements may undoubtedly be achieved. During these negotiations the computing experts would have to run a series of tentative solutions corresponding to what is achieved in the cause of the negotiations between the Commission and the delegations of the individual countries. Computations are necessary in this work because it is through them that the multilateral balancing is achieved.

---

[1] If a country tried to gain an unjust advantage by setting a too high export price or a too low import price it would simply price itself out of the market just as in an ordinary market.