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PROPOSAL FOR AN INTERECONOMIC BUDGET ANALYSIS AS PART OF THE EMPLOYMENT STUDY OF THE ECONOMIC AND EMPLOYMENT COMMISSION

(Submitted by the Member from Norway in Connection with Proposal, document E/CN.1/18)

In my memorandum of 23 January (document E/CN.1/18/Add.1), I drew attention to certain principles of analysis for intereconomic matrices which in my view are extremely important so far as economic development and employment is concerned. Presently I shall add some remarks that will point out the bearing which these principles have on certain problems of immediate practical concern which will come up for consideration by the Commission during its present session.

As an example I shall choose the far-reaching and important provisions under Articles 26 and 27 in the Draft Charter of the International Trade Organization (ITO) (pages 29 to 31 of the Report of the London Meeting, February 1946). Paragraph 1 of Article 26 states that a country that has a deficit on its balance of payments may impose import restrictions, and in the subsequent paragraphs a number of more or less complicated rules are formed regarding the way in which these import restrictions shall be applied, so as to cause the least possible decrease in total world trade. According to Section 3 (d) the matter may be brought before the ITO which may recommend to change the import restrictions and may put into effect certain punitive measures to be taken against any country that does not follow the recommendations. In the case of widespread application of import restrictions, the ITO may initiate discussions on general measures to be taken. These provisions in themselves seem rather recommendable.

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But the further rules contained in the draft charter specifying how the regulations are to be worked out, are very unsatisfactory from the viewpoint of optimal multilateral balancing. It seems that the authors of the draft have only considered the balancing problem from a one-country-at-a-time viewpoint without due recognition of the fact that the adjustment of any given item in the trade matrix will have a repercussion on the whole network of multilateral connections.

For instance, paragraph 2 (d) of Article 27 provides that the quota be allocated among supplying countries "in accordance with commercial considerations such as price, quality and customary sources", or possibly upon the proportions of the total quantity or value of the product supplied by member countries during a selected representative period. The analysis put forth in document E/CN.1/18/Add.1 shows, however, that the application of such proportionality principles will tend to reduce the aggregate trade by a larger amount than that which will be brought about if the balancing is performed in the optimum way. This is exemplified by a comparison of the method that leads to Table 5 with that leading to Table 6 in the said document.

In a general way, it is desirable, first to carry out first order adjustments; that is to say, to work towards the lowering of those items in the trade matrix that have the property of being at the same time an import item for a deficit country and an export item for a surplus country. The situation may be such that it is possible to reach a state of balancing by operations of this sort. Table 3 is an example in point. Indeed the balanced Table 6 is obtained from Table 3 by a first order adjustment. But the situation may be more complicated as shown by the example in Table 7 of the present memorandum.

/TABLE 7

TABLE 7

	1	2	3	4	5	
1	0	30	60	0	100	0
2	30	0	20	0	0	5
3	75	10	0	0	0	0
4	60	5	5	0	5	0
5	25	0	0	75	0	
	0		0	0	5	5

Here there does not exist any item which is at the same time an export item for a surplus country and an import item for a deficit country. Therefore, if the conditions imposed that the matrix should be brought into balance and no item increased, then it is in the present case necessary <u>to reduce one or more of the items for a country which is already in balance.</u>

If one item pertaining to a balanced country is changed, it becomes necessary to change correspondingly also another item pertaining to that country, in order that it shall be kept in balance. In other words, the kind of operation now to be considered is to reduce pari passu <u>both an import item and an export item of a country which is already in balance</u>, the import item in question being one that comes from a surplus country and the export item in question being one that goes to a deficit country. This is a <u>second order</u> operation. Here the elimination of <u>one</u> unit of skewness in the matrix entails a reduction of aggregate trade by <u>two</u> units (the skewness being defined as in the previous memorandum). Such a method of carrying the trade matrix towards balance may not be very appealing, but it is necessary if none of the items can be increased. The question is not whether one

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likes this way of bringing the matrix into balance or not, but whether the balancing shall be brought about by such a rational measure or whether one shall leave the balancing to be done by the time-honoured method of the freely working downward spiral, which will bring the aggregate trade down by a still more considerable amount. As an example of adjustments of this sort, Table 7 may be adjusted in the following way: The import from country 1 into country 2 (which in the table is equal to 30) is reduced by 5 and at the same time the import, for instance from country 1 into country 3 (which is 60) is reduced by the same amount, 5. This will bring the matrix into complete balance, and the aggregate trade is reduced by 10. In this case we reached the desired result by second order operations.

In still more difficult cases we may even need to go to <u>third order</u> operations. That is, operations where we reduce pari passu three items, one of which interconnects two balanced countries, the second item being the import from a surplus country into one of the two balanced countries and the third item being the import from the other balanced country to a deficit country. In this case aggregate trade will be brought down by an amount which is three times as large as the amount by which the skewness is brought down.

Without going into further detail, it is clear that it would be desirable to modify the draft Charter of the ITO at this point <u>if one has an optimal adjustment of international trade in view</u>. The Economic and Employment Commission, as a technical body in the economic and employment field, should advise the Economic and Social Council of this situation and propose a redrafting that will help towards the achievement of an optimal adjustment. The redrafting may consist in changing the rules regarding allocation of quotas and discriminatory quantitative restrictions so as to make them <u>automatically</u> more conducive to the purpose of keeping aggregate world trade at its maximum. But a more satisfactory solution would be obtained

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by boiling the rules down to a provision to the effect that the ITO shall act as a co-ordinating body which upon examination of the multilateral balancing problem may make recommendations to the members and may use coercive measures similar to those now under investigation in paragraph 3 (d) of the draft charter.

In either case will the success of the measures depend essentially on a continuous service of information, the results of which are presented in the form or an intereconomic budget analysis.

Ragnar Frisch

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