

the cost in foreign currencies calculated at the official exchange rate. In other words, in decisions whether to buy abroad or at home, foreign currencies were to be given a higher value than would correspond to the official parity.

Through tying foreign aid to purchases of our products, the United States reduced the value of its foreign-aid dollar. Countries receiving aid had to buy in this country even if they could have bought at lower prices elsewhere. It cost some of them about 30 per cent more, which corresponds to a devaluation of the aid-dollar by about 23 per cent.

In July 1933, the United States began taxing purchases of foreign long-term securities at a rate of 15 percent. This is the equivalent of devaluing the dollar used for buying foreign securities. This partial devaluation, designed to reduce capital outflows, is a financial, not a real, corrective.

Last month, in January 1937, the administration proposed a tax on foreign travel and tourism, which would be the equivalent of devaluing the tourist's dollar. In addition, there are nonofficial proposals for taxes or tariff-surcharges on imports—the equivalent of devaluing the dollar for imports—and for subsidies or tax-refunds on exports—the equivalent of lowering the price of the dollar to foreign buyers of our exports.

If these disguised devaluations of the dollar were uniform, affecting proportionally all imports, all exports, and all other international transactions, they might work indiscriminately and perhaps efficiently. As it is, however, they are selective, disproportionate, and inefficient. They discriminate against some sectors and in favor of others, distort the structure of prices and the allocation of productive resources, and are usually incapable of effecting their purpose.

Partial devaluations can improve particular items in the balance of payments, but may worsen others in the process, partly because of the substitution of purchases for which the dollar is not "devalued," partly because of foreign and domestic repercussions to the reduction of purchases for which the value of the dollar is reduced.

DIRECT CONTROLS

Partial devaluations have at least one advantage: they work through price incentives and disincentives, and leave the markets essentially free. The bureaucratic mind, however, prefers a more direct approach, a more direct attack on the "item" that has been found irritating or insalubrious: it prefers direct controls, which give to some governmental authority the power to prohibit, to restrict, to license, or to permit, according to its unfailing judgment of what is or is not warranted in the national interest.

Direct controls can be employed as real correctives or as financial correctives of the payments deficit. As real correctives they may involve discretionary subsidies to exporters, quotas and other nontariff restrictions on imports, licensing of foreign travel or fixing the amounts that travelers may spend abroad. As financial correctives they may restrict bank credits to foreigners, direct foreign investment, portfolio investment and foreign loans of various types.

The effectiveness of controls that are not comprehensive, not all-inclusive (as general foreign-exchange controls, comprising all foreign transactions would be) is limited by the possibilities of avoiding, evading, and circumventing the restrictions. The elasticity of substitution among different forms of capital outflow, for example, is not sufficiently appreciated; there are also those offsetting changes in other items that are classed as repercussions, though in some instances substitutions and repercussions shade into one another.

It should be easy to understand that portfolio investment, bank loans, trade credit, and direct investment may be substituted for one another. Restrict one and you will see the others expand. Yet, many overlook that there is also substitution between foreign and domestic funds. Restrict the outflow of American capital funds and you will see foreign funds withdrawn from the United States.

This is not retaliation or an unfriendly act, but the operation of normal market forces: if American funds are kept from going abroad, interest rates abroad will rise and, naturally, foreign funds will "go home." Or, if American firms are forbidden to use their own money for direct investment abroad, but are permitted to raise foreign funds in foreign markets, foreigners holding American securities may decide to sell them in New York and buy the more attractive new securities offered by the American subsidiaries abroad. Thus, a legitimate outflow of capital takes the place of a forbidden one. Call it repercussion or call it substitution, it severely limits the effectiveness of the financial correctives.

If financial correctives are effective in reducing the outflow of capital, they may induce offsetting reductions in the trade surplus. These repercussions or