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Volume Author/Editor: Robert M. Lichtenberg

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Chapter Title: Major Types of Middleman Trade

Chapter Author: Robert M. Lichtenberg

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2. MAJOR TYPES OF MIDDLEMAN TRADE

This section examines the relative extent and structure of three types of middleman trade — overseas territorial trade, trade between hard and soft currency countries, entrepôt trade — and the trends in their operation. These categories, somewhat overlapping, do not exhaust all middleman trade, but each has peculiar economic and statistical implications.¹

The Middleman in Overseas Territorial Trade

In section 1 it was shown that middleman trade in overseas territorial produce is a substantial component of the total middleman trade of the major metropolises and of the total trade of the dependent areas. This conclusion rests on evidence derived in part from records of the imports of seven selected countries but chiefly from data of only two countries of ultimate consumption or fabrication, Germany and Denmark.²

For the overseas territories of the U.K., studies by Bauer and by Stahl³ provide additional data which permit some generalizations about the dimensions of this type of trade and the broader role of middlemen in the economic activity of these countries. However, these authors in examining the activities of merchant firms from the O.T. point of view make no distinction between middlemen and the other category of resident aliens who sell to their own metropolises. Only rough adjustments can be made to disclose the activities of the international middleman.

Role of British Residents in Trade of British Overseas Territories

The export trade in all the overseas territories studied by Stahl (based on

¹While each of these types of middleman trade has been at one time or another partly based on force, monopolistic control, or the violation of official agreements, a large part of middleman trade is a legitimate and necessary part of a broad service industry — the distribution of commodities.

²From the precise data supplied by Germany and Denmark on middleman activities in colonial trade (Tables 10 and 11) we learn that in 1951 and 1952 this category comprised more than 30 percent of Denmark's imports from middlemen and more than 40 percent in the case of Germany (for a limitation in the German data, see note a to Table 11). Reports of Germany, 1951 and 1952, reveal the following percentages of the total middleman activity of each of the countries having overseas territories to be sales of produce of their own O.T.'s: U.K., 55 and 51 percent; France, 89 and 71 percent; Belgium, 88 and 73 percent. The corresponding percentages revealed by reports of Denmark for the same years were: U.K., 28 and 20 percent; France, 78 and 57 percent; Belgium, 47 and 31 percent.

³P. T. Bauer, *West African Trade*, University Press, Cambridge, England, 1954; and Kathleen M. Stahl, *The Metropolitan Organization of British Colonial Trade*, London, Faber, 1951. The second book is largely a series of company studies covering British East Africa, Malaya and Singapore, British West Indies and Ceylon before 1948 when Britain gave up its empire status. Scattered through the book, however, are some interesting general statistics.

their status before 1948) and by Bauer (based on their status before 1954) is, with few exceptions, almost entirely controlled by metropole companies; a high but smaller proportion of the import trade is controlled by the metropolises. All British West and East African trade, most of the trade of Malaya, Singapore, Ceylon, and that of the important sugar- and petroleum-exporting countries of the British West Indies fits this generalization. The share in this trade of firms resident in or with head offices in Great Britain is not always clearly stated by the authors. But the facts given bear out the generalization that at least 50 percent of the merchant-man trade in the produce of each of the territories is controlled by British interests, and in at least the most important exporting countries among the territories this control is in the hands of British firms resident in Great Britain.

Bauer carefully refrains from linking his statistics to specific firms but his hints suggest the deduction that at least three of the major West African firms with 55 percent of export merchanting are British.⁴ Stahl gives the following data for other territories.⁵ In Malaya 70 percent of rubber firms in 1940 were non-Asiatic, the majority being registered in Great Britain, a minority locally in Malaya, and a few in Hong Kong and Shanghai; 70 percent of the tin industry capital in 1938 was British. In British East Africa, British merchants "predominate." In Ceylon, before 1948, the share of British merchants was 90 percent on the export side and 50 percent on the import side. In the British West Indies, British merchants predominate in at least the major sugar trade of Guiana and Trinidad and in the petroleum trade of Trinidad.

Stahl makes little of the difference between "British interests" (with location of head offices unspecified)⁶ and British firms with head offices in Great Britain for the territories discussed except for Malaya (tin) and for Ceylon (tea) where perhaps half of the British firms are locally registered. In Malaya and Singapore, Chinese traders are second in importance to the British; in Ceylon, Indian and Chinese firms share about 10 percent of control of the tea trade. In the British West Indies, with the exception of the United Fruit Company (U.S.), control is either in London or local. In the West African trade discussed by Bauer, "expatriate"⁶ control is predominantly in the hands of European firms with head offices in Europe. The Indian merchants engage mainly in the Uganda cotton trade. The preponderance of British merchants in the sale of produce of major British O.T.'s implies that middleman trade is substantial where direct exports to

⁴Bauer, *op. cit.*, pp. 66-68, and 221.

⁵Stahl, *op. cit.*, pp. 39, 102, 112, 162, and 205.

⁶The terms "British interests" as used by Stahl and "expatriate" firms as used by Bauer are not defined precisely.

the U.K. are well below 50 percent. This is the case for the O.T.'s of Asia, East Africa, and the West Indies, but not for British West Africa.⁷

Structure of British Merchanting Firms in Overseas Territories

British activities extend into many aspects of production and trade of their overseas territories (as organized before 1948). In Malayan rubber and tin, Ceylon tea, and West Indian sugar the role of the merchant is intricately bound up with a variety of other economic activities. The predominant form of organization is the combination of agency house and plantation or mining company. In the Malayan rubber industry the agency house not only acts as merchant and frequently as shipper and insurer, but it also manages the estates of a number of companies; each activity is handled on a commission basis with a separate fee. In Ceylon tea, the arrangement is much the same but is complicated by the intermingling of sterling and rupee companies and sterling or rupee agency houses. In Malayan tin, on the other hand, the agency house usually is only an agent, with control of production and sale primarily in the hands of the local companies. The British West Indies sugar trade is even more complicated since the traders may be estate owners, merchants, brokers, limited liability companies controlling factories and estates in the West Indies — some with complete vertical integration to final importing company — or holding companies.⁸ In the African territories merchanting activities are somewhat limited. There, the first stage of importing and the last stage of exporting are largely (entirely on the export side) in the hands of non-African merchant firms, but the great bulk of buying and selling between producers and merchantmen is carried on by African native firms. The merchant firms engage in minor processing, and either own shipping and insurance companies or act as agents for them. These merchant houses were generally independent, buying and selling on their own account, before the advent of the marketing boards in World War II.⁹

The introduction of marketing boards has circumscribed activities of the West African merchants in agricultural products, reducing them to commission agents for the boards, though they still retain a certain freedom of action in buying and selling. In British East Africa some marketing boards have been established for coffee, though not — so far as I know

⁷In 1952, direct exports to the U.K. in percent of total exports were: Malaya, 20.8; Ceylon, 27.8; Kenya, 28.8; Uganda, 39.4; Tanganyika, 41.3; Trinidad, 39.5; British Guiana, 35.0; Nigeria, 78.0; Gold Coast, 40.7.

⁸This is, of course, also true of a type of trade by the U.K. and other middlemen which I have classified as multinational production.

⁹Commission merchants in East African coffee trade sold primarily to the U.K. and locally (Stahl, *op. cit.*, p. 233).

— for sisal. Coffee merchants still operate independently, however, buying from agents of the marketing boards at the Nairobi auctions.

For most colonies and territories the bulk of the export trade is directed by a small number of firms chiefly operating from headquarters in London, and often in several territories and in other world areas. In Africa the competitive structure is oligopolistic. In West Africa (Nigeria and the Gold Coast — now Ghana) the three largest firms purchased or exported on commission more than one-half of the volume of major commodities exported, and the five largest firms at least 70 percent. In East Africa, Stahl reports that there were only eight or nine British merchants in coffee and about twenty London firms in the sisal trade. Concentration of the bulk of the trade in a few companies is also found in the major products of the West Indies. Three companies control almost all of the trade in British Guiana sugar, two control the greater part of Barbados sugar and there are only three important British firms selling Trinidad produce. While control is more diffuse in Malaya and Ceylon, a few agency houses exercise a general control, through executive authority, over the affairs of many companies.¹⁰ There are only about two dozen agency houses in Ceylon tea, only a dozen of them important. In Malayan rubber the four leading agency houses control about one-fifth of the output. Agency house control is less significant in the tin industry, though some uniformity in policy results from this system as well as from interlocking directorates.

To summarize briefly, we find that these case studies support our limited indirect data on the predominant role of British firms resident in Great Britain in the sale of territorial produce and on the relatively small share of native concerns in the residual. The activities of the British sellers extend far beyond mere merchandising activities which may be only one stage in a vertically integrated control of production and trade. Control of all these operations, despite the intricacy of the organizational arrangements with intermixture of local and sterling enterprises, is generally directed from the London headquarters of a few British firms. This generalization excludes Ceylon, and must be qualified for the previously mentioned parts of Africa, where local marketing boards function, and for part of the tin trade of Malaya.

As to the historical trend, the importance of British and other nonnative firms does not appear to have declined significantly in the last fifty years, though there may have been some shifting to local registration. In some cases — as in West African trade — the native merchants have lost ground, relatively, with the rise in capital requirements and need for technical skills to handle a rapidly growing trade.¹¹ Large capital requirements for

¹⁰Stahl, *op. cit.*, pp. 103, 171-172.

¹¹Bauer, *op. cit.*, p. 118.

high cost dredging equipment have also helped the British interests in their competition with the Chinese in Malayan tin.¹² These remarks do not apply to the Malayan entrepôt trade. Not only have the British lost ground to the Chinese, but also the entrepôt activities have been reduced relative to merchandising of domestic produce by the loss of the export trade of some foreign producers to Hong Kong, the Netherlands, and other markets. Stahl notes that the decline in British entrepôt activities in Malaya has been closely associated with an increase in British middleman activities in the produce of Malaya.¹³

One might expect, however, colonial powers to lose part of their middleman position as their overseas territories achieve independence. Newly created local governments find it to their interest, political or economic, or both, to institute regulations that encourage and protect national firms in international trade at the expense of the international middlemen.¹⁴

Role of Middleman Trade in the International Flow of Hard and Soft Currencies

In a world of inconvertible currencies middleman trade is a factor to be considered in any study of the difficulties countries experience in maintaining a balance, in their exchange portfolios, of currencies of different degrees of hardness and softness. This must be reckoned with particularly in study of their problem of meeting their needs for convertible currencies. But how important a factor is it? If we ignore the effect of middleman trade on international distribution of income, part of middleman trade, as I shall show, has no effect on the interregional financial position of the producing, middleman, or consuming country; that is, it does not significantly alter the currency composition of the countries' currency portfolios. This part I call "neutral middleman trade." Of the nonneutral trade, a segment may alter the flow of hard currencies only indirectly through the effect on intercountry or interregional balance of payments equilibrium. For example, middleman activity between countries with a bilateral agreement may increase a deficit on current balance and lead to settlement in a hard currency (among other possibilities).

Table 17 classifies middleman trade in terms of these alternative implications for the international financial position of the producing and con-

¹²Stahl, *op. cit.*, p. 112.

¹³*Ibid.*, p. 88.

¹⁴Some evidence of this trend is given in the recent United States Department of Commerce studies on foreign investment opportunities. It is noted that British commercial interests have been considerably curtailed in India since independence (*Investment in India*, June 1953, p. 19), and that the Indonesian government has encouraged nationalists in foreign trade activities (*Investment in Indonesia*; February 1956, p. 96).

suming countries. It is based on data provided by two final importing countries, Germany and Denmark; and some of the underlying data are shown in Tables 10, 11, 12, and 13. For Germany, the monetary areas are classified in the source publication; for Denmark, I used the classification given by OEEC.¹⁵

Neutral Middleman Trade

For a high percentage of middleman trade, designated neutral trade (category 1) in Table 17, currency of payment and settlement problems of the producer and consumer are not affected whether payment is made by the consumer directly to the country of production or indirectly through the middleman country. As noted above, for German imports, purchases from the metropole middleman of produce of its own overseas territories are the major component of neutral trade and of total middleman trade; for Denmark these purchases are substantial.

Of the middleman countries in the other classes of neutral trade shown in Table 17, the U.S. is of course dominant in the sales of produce of the dollar area, the U.K. in the sales of the produce of the sterling area, and the nonsterling EPU middleman countries (see Table 4) sell most of the remainder.

Inter-Soft-Currency Country Trade Involving Possible Settlement Problems

Category 2 differs from neutral middleman trade in that, from the point of view of the producing and consuming countries, the activities of a middleman may either reduce or increase interregional disequilibrium, a possibility that is intensified by the fact that a large portion of trade between soft currency countries is conducted under bilateral agreements.¹⁶ When the clearing currency of a bilateral agreement depreciates, there is an additional incentive to middleman activity. This is discussed below under the more general category of "switch trade."

¹⁵The OEEC reports that "The dollar area cannot be defined geographically. In fact trade with certain countries of Latin America and the Middle East is settled in dollars on the basis of bilateral agreements and according to whether or not they refer to certain transactions. However, trade with the countries [included in the dollar area in Table 17] must always be regarded as trade with the dollar area. . . ." (*Definitions and Methods*, OEEC Statistical Bulletin, 1955, Part III, p. 66). While a certain amount of transactions in dollars is necessarily incorrectly classified in Table 17 this table is not concerned with country or area of *settlement* but country or area of *payment*. The grouping of areas is designed to reveal the significance to settlement problems of payment to a middleman country.

¹⁶One hundred and eighty-one such agreements between Continental OEEC countries and the rest of the world are listed by Ray Mikesell and M. N. Trued in *Postwar Bilateral Payment Agreements* (Princeton Studies in International Finance No. 4, 1955, p. 14).

TABLE 17

Merchandise Purchases by Germany and Denmark from Country Other than Country of Production, Classified by Monetary Areas of Production, 1951 and 1952

(value in millions of dollars, and percentage distribution of grand total)

MONETARY AREA OF MIDDLEMAN	MONETARY AREA OF PRODUCTION	I M P O R T I N G C O U N T R Y							
		Germany			Denmark ^a				
		1951		1952		1951		1952	
1. Neutral trade for currency and settlement problems		Value	Percent	Value	Percent	Value	Percent	Value	Percent
Metropole middleman	Own O.T.'s	303.5	41.4	330.7	38.8	37.9	22.1	24.9	17.2
Dollar area	Dollar area	121.2	16.5	100.7	11.8	9.1	5.3	6.1	4.2
Sterling area	Sterling area	95.3	13.0	60.7	7.1	11.5	6.7	8.4	5.8
Nonsterling EPU	Sterling area	22.9	3.1	41.3	4.8	2.3	1.4	3.2	2.2
Sterling area	Nonsterling EPU	18.0	2.5	30.0	3.5	30.5	17.8	28.7	19.8
Nonsterling EPU	Nonsterling EPU	42.7	5.8	56.9	6.7	1.4	0.8	1.9	1.3
Soviet bloc	Dollar area	3.5	0.5	13.1	1.5				
Total neutral trade for currency and settlement problems		607.1	82.8	633.4	74.2	92.7	54.1	73.2	50.5
2. Inter-soft-currency country trade									
Sterling area	Bilateral agreement			11.8	1.4	18.6	10.9	6.7	4.6
Sterling area	Other soft ^b	5.5	0.8						
Nonsterling EPU	Bilateral agreement	18.3	2.5	22.7	2.7	12.3	7.1	17.9	12.4
Nonsterling EPU	Other soft ^b					0.3	0.2	0.3	0.2
Other soft	Sterling area					3.1	1.8	4.0	2.8
Other soft	Nonsterling EPU			0.4	0.1				
Other soft	Bilateral agreement			5.4	0.6				
Other soft	Other soft ^b					0.9	0.5	1.0	0.7
Soviet bloc	Soviet bloc					0.6	0.4		
Sterling area	Soviet bloc			2.2	1.3			3.0	2.1
Nonsterling EPU	Soviet bloc			6.1	3.6			2.0	1.4
Other soft	Soviet bloc			1.5	0.9			4.6	3.2
Total inter-soft-currency trade		23.8	3.3	40.3	4.8	45.6	26.7	39.5	27.4

TABLE 17, concluded

MONETARY AREA OF MIDDLEMAN	MONETARY AREA OF PRODUCTION	I M P O R T I N G C O U N T R Y							
		Germany				Denmark ^a			
		1951		1952		1951		1952	
		Value	Percent	Value	Percent	Value	Percent	Value	Percent
3. <i>Dollar costing or inter-soft-currency trade</i>									
<i>(for importer)</i>									
Dollar area	Sterling area	9.3	1.3	5.6	0.7	0.3	0.2	0.8	0.5
Dollar area	Nonsterling EPU and O.T.'s	3.6	0.5	5.4	0.6	16.3	9.5	10.5	7.3
Dollar area	Bilateral agreement	17.4	2.4	6.8	0.8				
Dollar area	Soviet bloc ^b			0.4	0.2				
Dollar area	Other soft ^b			1.2	0.6			0.8	0.5
Soviet bloc	Nonsterling EPU and O.T.'s	0.3							
Soviet bloc	Bilateral agreement	1.6	0.2	1.5	0.2				
Total dollar costing or inter-soft-currency trade		32.2	4.4	19.3	2.3	18.2	10.5	12.1	8.3
4. <i>Dollar saving trade (for importer)</i>									
Sterling area	Dollar area	30.5	4.2	86.2	10.1	4.6	2.7	8.0	5.5
Nonsterling EPU	Dollar area	39.7	5.4	60.5	7.1	7.1	4.1	10.9	7.5
Other soft	Dollar area	0.2		13.1	1.5	3.6	2.1	1.3	0.9
Total dollar saving trade		70.4	9.6	159.8	18.7	15.3	8.9	20.2	13.9
Grand total		733.5	100.0	852.8	100.0	171.73	100.0	145.0	100.0

^aDenmark includes minor EPU middleman countries in "other."

^bIncludes bilateral agreements.

Source: Germany, *Der Aussenhandel der Bundesrepublik Deutschland, 1951 and 1952*, Teil 3; Denmark, *Foreign Trade of Denmark, 1951 and 1952*.

Dollar Costing or Dollar Saving Trade from Standpoint of Importing Country

The remaining two categories, 3 and 4, in Table 17 show, primarily, the part of middleman trade which directly affects the international distribution of hard currencies, though there are probably some exceptions in category 3, and part of category 2 might be included, in theory at least, as representing trade between countries of different degrees of hardness of currency.

Dollar Costing Trade. In category 3, the purchases by Denmark of non-sterling EPU and O.T. produce from a hard currency country are chiefly the result of U.S. control of part of petroleum exports of the Netherlands Antilles. Because of the activities of U.S. multinational petroleum producers, Denmark must pay dollars rather than EPU currency for petroleum. Similarly, part of the sales by U.S. middlemen of soft currency produce to Germany probably results from multinational production by U.S. firms (not petroleum in this case) and part from normal trading activities of U.S. merchants.

Sales by dollar area middlemen of produce of the U.K. and non-sterling EPU are, however, difficult to explain. They may not involve dollar sales but merely represent the use of inconvertible receipts from overseas operations by U.S. investors for purchase of products required by their plants in Germany.

Dollar Saving Trade. The purchases by Denmark and Germany shown in category 4 are clearly dollar country imports purchased from soft currency countries at the cost to importers of a premium. This section, like part of category 2 above, falls under the broader heading of "switch trade."

Thus, for a minimum of 50 percent of imports via middlemen by Germany and Denmark in 1951 and 1952, middleman activity, apart from profits and other service income, has no effect on the international financial position of all countries concerned. For a minimum of 78 percent the effect is limited to intensifying or reducing bilateral settlement problems, except for a possible variation in usefulness of different soft currencies to countries concerned. For the remainder, middleman activity affects the hard currency holdings of the countries concerned, but (for Germany and Denmark) there is some offsetting of dollar saving trade by dollar costing trade.

On the export side, sales by powers with dependencies of O.T. produce to the dollar area are generally neutral, as I have defined the term, and this is true to some extent of sales by the sterling area of sterling area

produce, though exceptions can be found.¹⁷ But only fragmentary data are available on the relative importance of the other classes of sales of soft-currency country produce to the dollar area by soft-currency country middlemen. Germany provides export data for 1953 and 1954 which, though possibly underestimated, show that her dollar costing exports were about one-third of her dollar saving imports in these years, and were largely offset by dollar saving exports.¹⁸ In exports by the sterling area, middleman trade with the dollar area is known to have been closely associated with the turnover of inconvertible currency in foreign markets. Of these, New York is considered the major market by Mikesell who estimates its average annual turnover of inconvertible sterling in 1951 and 1952 to have ranged from about \$70 million to nearly \$300 million.¹⁹ Thus the generalization appears reasonable that only a small proportion of the estimated \$9,526 million world middleman trade involves shifts in dollar holdings between any of the parties — exporter, importer, middleman.

Although this type of middleman trade is relatively small, its importance in the postwar period is a result of the sensitiveness of countries to small changes in their dollar balances and also the intensive activity of middlemen in commodities of countries suffering from heavy unofficial discounts on their currencies. This “switch trade” or “commodity shunting” has been sufficiently large relative to hard currency holdings and net currency earnings of the U.K. in the very short run during the postwar period, for example, to call forth major policy reactions.

Switch Trade

The form of commodity arbitrage, switch trade, has received much attention in the European press in the postwar period. When the country of production or the country of consumption of internationally traded commodities, or both, discriminate as to the direction of trade or payment or the two combined so that broken cross rates or commodity premiums cannot be corrected by currency arbitrage or direct trade, middleman coun-

¹⁷Hong Kong is an exception to the statement about sales of produce of own O.T.'s, in that exchange earned by Hong Kong merchants from shipment to the dollar area of goods originating in Hong Kong as well as in Macao, Korea, and Taiwan does not have to be surrendered to an authorized bank and sold at official rates (Frank H. H. King, “Money in British East Asia,” draft report to British Colonial Office, January 7, 1955). For independent members of the sterling area, participation in dollar pooling varies with individual dollar positions of separate members (Kenneth W. Wright, “Dollar Pooling in the Sterling Area, 1939-1952,” *American Economic Review*, September 1954, p. 566).

¹⁸*Der Aussenhandel der Bundesrepublik Deutschland, 1953 and 1954*, (Statistisches Bundesamt, Wiesbaden), Teil 3, pp. 50 and 42, respectively.

¹⁹Raymond Mikesell, *Foreign Exchange in the Postwar World*, Twentieth Century Fund, 1954, pp. 194-195.

tries can make a profit by circumventing the discriminatory regulations. Following the usage of much of the European press I shall refer to all such transactions as "switch trade."²⁰

Switch trade may involve no more than the re-export by country B of A's products to C if C's importers are permitted to buy more freely from B than from A, or A's exporters are permitted to sell more freely to B than C. If the middleman obtains a soft currency as a result of the transaction he may recover the hard currency by taking a loss on the sale of soft currency commodities to the hard currency country. Some extremely complex operations may be necessary, however, to complete a switch deal since three elements are involved: the supply and demand conditions for commodities and for currencies; and the varying loopholes in the trade and payment restrictions of different countries.

Although switch transactions are frequently referred to in a derogatory vein by the European press, they are essentially a means of liberalizing discriminatory restrictions. And, as succinctly stated by Haberler, "... the basic objection against any kind of discrimination is that it constitutes an infringement upon the optimal conditions of international division of labor and therefore entails a diminution of world income as compared with a nondiscriminatory free trade position."²¹ While switch trade is certainly not the best method of liberalizing discriminatory restrictions, it does increase world trade and is probably a step in the direction of optimal division of labor, particularly when the market for such transactions is not highly imperfect.

Individual countries attempting to discriminate may suffer from switch trade through a resulting adverse change in the terms of trade and aggravation of interregional balance of payments problems. But the tacit support of many such transactions by the central bank of the discriminating country reveals the discriminatory policy as a partial failure. When this support is withheld these transactions, in view of the high cost of switch trade, indicate that the discriminatory policy is supporting a severely mal-adjusted economy.

Since 1949 switch trade has been newsworthy in the European press.²²

²⁰Other authors reserve the use of this term for only some types of the above transactions. Mikesell, for example, distinguishes between switch transactions, conducted at the official rates of exchange, and cheap currency transactions (*ibid.*, pp. 178-180). The British press refers to middleman transactions involving cheap sterling as "commodity shunting."

²¹Gottfried Haberler, "A Stock-Taking of Bretton Woods Objectives," *American Economic Review, Papers and Proceedings*, May 1953, p. 92.

²²"The Netherlands Bank, to stimulate efforts to export to countries of the dollar group, (in 1949) allowed Dutch traders to retain a stipulated percentage of dollars received in payment for exports. These dollars could be used to buy from countries of the dollar area commodities wanted by soft currency countries who were willing to pay a much higher price in their own currencies than they would have to

Reports note such activities by residents of Continental countries including the Netherlands, France, Italy, Denmark, Germany, Belgium, and Switzerland. The British are also known to have carried on some activities of this type.

The data presented in section 4 of Table 17 show a part of one pattern of switch trade: the resale of dollar area goods to Western European countries by middleman countries at a premium and, if possible, recovery by middlemen of the dollars by resale of Continental goods to the dollar area at a discount. In this pattern the U.K. and the Netherlands were the major middlemen for Germany and Denmark in 1952 and for Germany (at least) in 1953 and 1954.²³

The major role of the U.K. in this pattern of switch trade is not publicized. Although a relatively minor part of U.K. middleman activities, it is particularly interesting as a reflection of initial movements by the U.K. toward currency convertibility. In 1951, most of the switch imports by Germany from the U.K. were not dollar area *proper* produce (i.e., as defined by the OEEC), but Soviet bloc produce; in the following three years, dollar area proper produce exceeded other switch imports by Germany from the U.K. In 1952 this resulted from the temporary relaxation of exchange control by the U.K., partly in an effort to correct a heavy swing by EPU against the U.K. During the week in August of that year when the controls were relaxed British merchants spent about 60 million pounds sterling on dollar area proper produce for resale to third countries.²⁴ U.K. switch exports to Germany in 1953 declined by 50 percent but remained 16 percent of total German switch imports, and in 1954 they rose in magnitude but fell to 14 percent of total German switch imports as a result of a sharp increase in Netherlands switch trade with Germany. The U.K.'s switch trade in these years reflects in part its step-by-step relaxation of exchange controls on individual commodities under the so-called "commodity schemes."²⁵

pay had dollars been available for making payments directly. The soft currencies taken in payment were by tacit consent available to pay for the purchase of exports of commodities wanted in countries of the dollar group. Thus the Dutch firm recovered the dollars" (*Statist*, January 2, 1954, p. 14).

²³German imports of switch products (special trade) for 1953 amounted to \$189 million and for 1954, \$245 million (*Statistisches Bundesamt, op. cit.*).

²⁴*Bank of England Report, 1953*, p. 12.

²⁵At the time of the Bank of England Report for February 1954, schemes involving very slight restrictions on trade had been established for copper, lead, rubber, tin, and zinc (copra was added later in 1954). Whatever their origin these commodities can be traded throughout the world on a sterling basis. For other commodity schemes there are additional restrictions: coffee, cocoa, and raw sugar (as of 1954) if of other than sterling area or dollar area origin and purchased for dollars may be resold only for dollars; and other commodity schemes exclude switch trade entirely (*Sixth Annual Report on Exchange Restrictions*, International Monetary Fund, 1955).

For Germany, switch trade has meant substantial dollar savings in trade with the dollar area in recent years, savings offset to only a small extent or not at all by other middleman activities. As noted above, exports from Germany switched by soft-currency country middlemen to the dollar area have been small (though possibly underestimated) relative to switch imports — about one-third in 1953 and 1954; and the relatively small amount of dollar costing imports of Germany (section 3 of Table 17) have been offset, almost or more than completely, by dollar saving exports in the period 1952 to 1954. Thus, in these three years the German trade balance deficit with the dollar area has been substantially reduced each year as a result of switch imports.²⁶

A second major pattern of switch trade — very disturbing to the British — is the resale by middleman countries of sterling area goods to the dollar area whenever the discount on inconvertible sterling is high enough for profitable switch trade. The U.K. financial press discloses the highly erratic nature of the switch trade and the strong steps taken by the British government to prevent loss in dollar earnings in the postwar period. In the following review of evidence on this pattern provided by the press the underlying factors determining the fluctuations in the discount on inconvertible sterling will not be considered.

In 1949, when switching of sterling commodities began to attract attention there were more than a hundred varieties of sterling. Traders in American account areas, for example, could buy from New York dealers at a discount many types of inconvertible currencies. Then, acting through an agent in the middleman country to which the account applied, they imported sterling area goods, the commodities being consigned first to the middleman country and then to the United States. Other techniques of switching sterling commodities involve a middleman as a principal. For example, Dutch middleman traders with their permitted 10 percent of dollar earnings could buy cheap sterling in New York and begin a continuous trade of buying sterling area commodities, reconsigning them to the dollar area, and selling the dollars earned for cheap sterling. The discount rate on transferable account sterling in American account sterling necessary to make switch trade profitable in 1949 was probably between 5 and 10 percent, depending upon the unit value of the commodities involved.²⁷ It is thus significant that in the months preceding the 1949

²⁶Comparing Germany's balance of trade (imports c.i.f.) with the dollar area on a production-consumption basis with its balance of trade with the dollar area on a purchase-sale basis we find a reduction of the deficit in 1952 from \$439.9 million to \$350.2 million; in 1953 from \$164.0 million to \$47.1 million; in 1954 from \$202.5 million to \$14.7 million (*Report of the Bank Deutscher Länder, 1953, Table 10, p. 91, and 1954, Table 13, p. 104*).

²⁷A correspondent of the *London Financial Times* reported, 1949, the opinion of international trade experts that a 5 percent discount was sufficient for trading in a

devaluation, transferable account sterling was selling in New York at a 25 percent discount and in Hong Kong at more than 30 percent. The magnitude of switch trade is not known, but Sir Stafford Cripps stated that switch trade was a major factor in the decision to devalue the pound. Following the devaluation there was little switch trade "for well over a year."²⁸ But in 1951 and early 1952 switch trade rose as the transferable pound fell to \$2.40 in January 1952 and remained below \$2.61 until May 1952 against an official selling rate of \$2.786. The discount was less than 4 percent in 1953 and fell to nearly zero by April 1954.²⁹

The merger of 79 varieties of sterling into transferable sterling in March 1954 made switch trade possible on a much narrower margin than before. According to the *London Financial Times*, the supervision required to separate capital from currently earned sterling became practically impossible.³⁰ The *Economist* reported in the first months of 1955 that a 3 percent discount near the end of 1954 and continuing was associated with a recovery in switch trade, and that "The Bank of England is plainly worried by the renewed loss of dollar income to the sterling area through commodity shunting operations."³¹ It also observed that sale by British merchants of dollar goods to the Continent had been made much easier by relaxation of restrictions on their purchases of dollar goods. Since from February 1955 through at least October, however, the transferable sterling rate was not lower than \$2.75 (partly at least owing to activities of the Exchange Equalization Account), this type of switch deal undoubtedly once again disappeared.

Switch trade is also a significant factor in the trade of countries with bilateral agreements. When a heavy swing develops against one of the parties to the agreement, the clearing accounts are sold at a discount in New York and cities of Europe, South America, and Africa, with development of middleman trade in the commodities of the country having depreciated currency. In some cases, however, the debtor country takes the initiative and relaxes controls so that the goods can move directly to the consumer country. For example, Brazil announced early in 1955 that its

wide variety of commodities, and 10 percent for switching of manufactured goods. In 1952 the money market editor of the same newspaper gave a more conservative estimate of 10 percent for most deals: 2-3 percent for commissions at the transshipment points, and an additional 7-8 percent for the trader's profits and the price cut required for American participation (*London Financial Times*, November 16, 1949, and January 24, 1952). In 1954, however, after the merger of many varieties of sterling a discount of 2-3 percent was found to be sufficient for switch trade in a large number of commodities.

²⁸*London Financial Times*, January 24, 1952.

²⁹*Economist*, January 29, 1955.

³⁰*London Financial Times*, February 26, 1955.

³¹*Economist*, January 29 and February 12, 1955.

cotton exports could be purchased by hard currency countries with Yugoslav-Brazilian clearing account units, a transaction which should result in a saving of about 12 percent. However, if payment was not made in hard currency Brazilian exporters were expected to raise their prices by 4 percent.³²

To summarize briefly: Available data indicate that only a small (but important) part of middleman trade directly affects the international inter-currency area financial position of producing and consuming countries. Switch trade acts as a safety valve for bilateral agreements, it is an indicator of disequilibrium, and for many countries it contributes notably to net changes in dollar balances. Annual data cannot clearly reveal the pin-point effect of this highly erratic component of middleman trade which, in many of its patterns, tends either to restore interregional equilibrium in the short run or to call forth counter measures by countries being drained of their hard currencies.

Relative Importance of Entrepôt Trade, Other Reconsignment Trade, and Offshore Merchanting

One of the implications of the data examined in section 1 is that the historically important entrepôt trade, or re-export from customs storage warehouses, is now a relatively minor part of total middleman trade. This can be shown by comparing the value of re-exports of the U.K. (1953), the U.S. (1952),³³ and the estimated value of entrepôt trade of the Netherlands (1951)³⁴ with total middleman activity of each of these countries in trade with the seven selected importing countries (1952). Total U.S. and U.K. re-exports to the world were smaller than their middleman activity with these seven countries; the Netherlands re-exports were perhaps slightly larger than its middleman activity with these countries. Yet, as noted above, these seven countries imported in 1952 only 11.2 percent of world imports. A comparison of the re-exports (f.o.b.) of the middleman countries to the seven countries with their corresponding middleman trade (c.i.f.) for 1952 shows: for the U.S. re-exports were only 5 percent of middleman trade, and for the U.K. only 8 percent; for the Netherlands, as shown in Table 14, most entrepôt trade goes to the Continental OEEC countries.

³²Forex Service No. 10, May 15, 1955, p. 4.

³³*United States Exports of Domestic and Foreign Merchandise*, Report No. FT 420, Department of Commerce, April 1952; *Annual Statement of Trade and Navigation of the United Kingdom, 1953*, United Kingdom Statistical Office of Customs and Excise Department, Vol. II.

³⁴See section 1, under Netherlands trade records, for explanation of derivation of Netherlands middleman activity from entrepôt and transit-with-transshipment trade records.

A secular decline in the relative importance of re-export trade and even in the broader category of reconsignment trade in total world trade may be discerned from the evidence, while our limited information on total middleman activity does not indicate a corresponding decline.³⁵ Table 18 shows the steady secular decline in the relative value of U.K. re-exports from 27 percent of domestic exports reached in the 1880's to about 4 percent in recent years. Rougher data on volume of re-exports also show a decline of re-exports relative to domestic exports between the pre-World War I and interwar periods. This relative decline was primarily the result of a contraction of re-export trade in raw materials with the major industrial nations.³⁶ The percent of total re-exports consigned by the U.K. to the U.S., Germany, and France fell from above 50 percent in 1924-1926 to 40 percent in 1934-1936, and to 38 percent in 1951-1953, though the U.S. share recovered somewhat from its slump in the 1930's. In this decline the major role of the chief raw materials — wool, rubber, and cotton — is shown by their proportions of re-export value: 40 percent in 1924-1926; 33 percent in 1934-1936; and 30 percent in 1953. Yet these three commodities have retained their relative importance in world trade since at least the mid-thirties: 6.6 percent of value of world exports, 1937; 8.8 percent, 1950; and 6.2 percent, 1952.³⁷

Data on all reconsignment trade of the major industrial middleman countries of Western Europe is provided by a study of U.S. imports in the period 1923-1936³⁸ when the U.S. reported imports on a consignment basis. The evidence indicates a considerable interwar decline in volume of reconsignment by Western Europe of food and raw materials originating in the relatively underdeveloped countries, with particular clarity for food and raw materials originating in the overseas sterling area. While the decline in volume of U.S. imports from the U.K. (on the basis, 1935-1939 equals 100) was from 192 in 1924-1926 to 138 in 1929-1931, and to 105 in 1934-1936, the rise in volume of imports from the overseas sterling area was from 82 in 1924-1926 to 96 in 1929-1931, with a slight fall to 90 in 1934-1936. Volume indexes are not given separately for the overseas territories of other Western European countries, but pertinent findings

³⁵As noted above, case studies of British overseas territories show that expatriate firms, most of which are not resident in these territories, have retained if not increased their relative importance in sale of produce of these territories in the twentieth century. A probable exception is the status of expatriate firms operating in former O.T.'s that are now independent.

³⁶*Statistical Abstract for the United Kingdom, 1937; Annual Abstract of Statistics, 1953*; also *Annual Statement of Trade, 1953*, London, H. M. Stationery Office.

³⁷*International Financial Statistics*, International Monetary Fund, April 1954, p. 26.

³⁸J. Adler, E. P. Schlesinger, and E. Westerborg, *The Pattern of United States Import Trade Since 1923*, Federal Reserve Bank of New York, 1952, Chart VIII, p. 31.

TABLE 18

United Kingdom Re-exports as Percent of Domestic Exports, 1871 to 1954^a

YEARS	RATIO OF RE-EXPORTS TO DOMESTIC EXPORTS (current prices)	RATIO OF RE-EXPORTS TO DOMESTIC EXPORTS (1913 prices)
1871-1873	23.8	25.5
1881-1883	27.1	25.5
1898-1900	23.9	27.8
1911-1913	22.1	21.5
1924-1926	18.4	25.3
1927-1929	15.7	20.2
1931-1933	13.8	19.6
1934-1936	12.6	
1948-1950	3.8	
1951-1952	5.2	
1953-1954	3.9	

^aThe data are adjusted to the old area of trade statistics (i.e. United Kingdom of Great Britain and Ireland) until 1936. The re-export volume data are constructed by weighting current year quantities by 1913 prices, while the total domestic export volume data are constructed by linking quantities weighted by prices of 1880, 1902, or 1929 to those on the 1913 price basis.

Source: Werner Schlote, *British Overseas Trade*, translated by W. O. Henderson and W. H. Chalmer (Oxford, 1952). For the postwar period data are from *International Financial Statistics*, International Monetary Fund.

show a sharp decline in these years in volume of U.S. imports of crude and semimanufactured goods from the Netherlands, France, and Italy relative to the decline in volume of total imports; and, between 1923 and 1936, a decline in the quantity of transshipments of tea, coffee, rubber, and other U.S. imports from France, the Netherlands, and the U.K.

This analysis of existing data suggests that reconsignment trade from customs storage warehouses of industrial countries is a minor part of their middleman trade, and that it has been a declining part of their total trade in the twentieth century, if not for a longer period. Middleman activities of the major industrial nations, therefore, are primarily offshore, the chief exception being the borderline element, direct transit trade. For the U.K., transit trade is — to judge by available data — relatively unimportant; for the Netherlands, on the other hand, it may still be heavy.³⁹

But, unlike the reconsignment trade of industrial countries, this type of middleman activity continues to be an important function of some countries closer to the sources of major raw materials. This is shown in the tabulation of re-exports of the British Commonwealth, Table 19. A large

³⁹Karreman's analysis indicated that entrepôt trade in 1951 accounted for 6 to 7 percent of special exports, and middleman activity in the transit-with-transshipment trade record for at least another 6 to 7 percent, probably more.

TABLE 19

Re-exports of Selected Commonwealth Countries in Value and as Percent of Total Domestic Exports, 1948-1951

COMMONWEALTH COUNTRIES	P E R C E N T					AVERAGE VALUE OF RE-EXPORTS 1950-51 (millions of dollars)
	1948	1949	1950	1951	1948-51	
Total	7.9	8.2	10.9	11.4	10.0	2,030.6
Malaya	84.4	85.2	85.8	85.2	85.3	749.4
Hong Kong	1,782.7	1,783.1	1,805.8	1,328.1	1,591.6	662.9
United Kingdom	4.0	3.2	3.9	4.9	4.1	296.0
Union of S. Africa	9.7	10.6	9.6	10.7	10.3	65.5
Aden and dependencies	a	a	a	a	a	63.7
India	2.0	3.7	3.7	2.8	2.8	43.4
Canada	1.2	1.0	1.2	1.2	1.2	41.2

^aNo domestic exports.

Source: *Statistical Abstract for the Commonwealth, 1948-1951*, Board of Trade, London, H.M. Stationery Office, 1952, p. 4.

part of the entrepôt activities of the two major re-exporters of the British Commonwealth — Malaya and Hong Kong — represents offshore activities of British merchants, most of the residual being handled by Chinese traders.

Malaya's entrepôt activities are centered in the two ports Singapore and Penang from which are re-exported produce (rubber, rice, copra, coffee) of Thailand, Burma, Indonesia, and sterling area countries of Southeast Asia. To these countries the entrepôt ports also supply manufactured imports from the industrial countries. Hong Kong, until recently almost entirely a re-export center, has experienced since 1949 a rapid development of its own industry, with domestic exports rising by 1953 to about 30 percent of total exports. While its entrepôt activity is chiefly in trade between Mainland China and the West, Hong Kong merchants also buy and sell for other countries of the Far East. In this they are supported by the unique duality of the exchange system — official sterling controls and open dollar market — and by extensive banking facilities.⁴⁰

It thus appears that where entrepôt activity by foreign middlemen is significant it has to a large extent retreated from the industrial centers of Western Europe to countries much closer to the sources of supply of staples, and, in the British Commonwealth at least, it is largely one part of offshore merchanting. The changes and decline, explained

⁴⁰See King, *op. cit.*, for discussion of the ramifications of this duality.

by special factors in particular situations, reflect also general developments in world industry and trade. Entrepôt, providing the services to producer and consumer country of a continuously functioning, single large market place, must have advantages sufficient to outweigh the extra cost of shipment and handling of merchandise, and its possible deterioration in storage. But, more and more, use of a single center has become awkward. Growth of industrialization in producing and final consuming countries, with development of transportation, communication, and facilities for storage and for minor processing, have reduced the need for use of a third country's facilities. Moreover, special requirements for particular qualities of formerly staple products have developed. And commodity exchanges, of course, further reduce the usefulness of the central entrepôt as a market place. Although these changes affect the middleman as a merchant, their effects on entrepôt activity are more immediate.

3. SOME IMPLICATIONS OF MIDDLEMAN TRADE FOR INTERPRETATION OF COUNTRY TRADE AND PAYMENTS RECORDS

Effect on Trade and Payments Records Generally

This study of the directional patterns of middleman trade suggests that the complexities of these activities result in serious distortion when trade and payments records of many countries are utilized for analysis of trade at the commodity level by direction of purchase-sale, and for analysis of a country's interregional current balance or interregional financial position. This hypothesis derives from evidence on the large volume of middleman trade, its high concentration in certain producing countries, certain commodities, and certain middleman countries, and from the fact that most countries report their trade on an origin-destination or consignment basis rather than on a purchase-sale basis. Producing countries may correctly report the country of sale when the middleman country is the country of consignment. But in the light of the data presented here, this type of middleman trade is relatively small; entrepôt trade and apparently other borderline types of reconsignment by major middleman countries (except the Netherlands) are minor. The hypothesis