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ESSENTIALS OF A MODERN TRADE POLICY

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This discussion is intended to help people understand the nature of international trade, the problems and opportunities we now confront, and some of the major current issues in foreign trade.

THE NATURE OF FOREIGN TRADE

Foreign trade, like any other kind of trade, is based on the principle of specialization and exchange, the economic apparatus for better living. With voluntary international trade, each country produces those goods and services for which it has a comparative advantage. The United States is a large country with a great diversity of resources and skills, able to meet most of her needs from her own sources but nevertheless with a considerable interest in foreign trade. For example, this country has natural advantages in the production of both machinery and wood products. Comparatively, our resources are better for production of machinery than for wood. We, therefore, sell some of our machinery to the Scandinavians in exchange for some of their timber and pulpwood. The exchange is voluntary. Each country exchanges something it has for something it would rather have. Thus, by engaging in trade each country improves its over-all position.

Basically, therefore, foreign trade is like domestic trade, in which Pennsylvania exchanges steel products for Iowa's pork and beef. It is like individual specialization and exchange, with farmers selling cotton and buying clothes, though they could and once did produce both.

Foreign trade, however, is more complex than trade within our own borders. Various currencies are involved, more restrictions are used, and governments play a larger role.

CHANGING TIMES

For many years we heard about the "dollar gap," a shortage of gold and dollars abroad which limited exports from our farms and factories. Now we hear about the "balance-of-payments problem," referring to a shortage of gold and foreign exchange (money) with which to meet international obligations, not abroad but here in the United States.

In earlier years, farmers were told that it was important to keep prices of their export crops competitive, so they could move in international trade. Now, subsidy makes a number of price-supported crops

competitive in foreign trade almost regardless of the domestic price.

Until recent times farm exports went to countries which had dollars (sometimes these dollars were granted by the United States) and were limited by the number of dollars these countries had. Now, through Public Law 480, we sell wheat, cotton, soybean oil, and other surplus products to countries which do not have dollars.

Formerly producers of cotton and other export crops sought the cooperation of industry and labor in support of a liberal trade policy which would permit foreigners to earn dollars with which they might buy American farm products. Now certain sectors of industry and labor are seeking the help of farm people in support of protectionist trade policies to keep foreign goods out.

What brought about these changes? Are we truly in a new situation? What constitutes an appropriate modern trade policy? These questions farmers are asking have their origin in major shifts in the structure of foreign trade, the significance of which are not fully realized. Tracing these changes will help farm people understand their new circumstances.

A BIT OF HISTORY

After World War II, our trading partners in Europe and Japan were flat on their backs. Their farms were damaged and their factories lay in ruins. Their reserves of gold and dollars had been virtually exhausted; we held the bulk of the world's supply of gold. They could not buy our food and industrial products, much though these were needed.

We undertook to help our allies as well as our former enemies get on their feet economically. This effort came largely from the hope, later rewarded, that if these countries could quickly recover their strength, they would be heartened to continue as members of the society of free nations. We felt compassion for people in desperate need, and we felt gratitude for the wartime sacrifices of our allies. We believed, also, that a prosperous neighbor is a good customer. In short, we felt that we stood to gain, diplomatically and economically, from the early and full recovery of our international neighbors.

So we provided military, economic, and technical assistance. We exported capital, both private and governmental. We reduced trade barriers on a reciprocal basis, allowing each country more ready access to the other's market.

And recovery occurred. By hard work, resourcefulness, and generally sound public policies, and with our help, the war-devastated countries got back on their feet.

Recovery of World Agriculture, and U. S. Farm Policy

Recovery came soon in agriculture. Damage to the fields and herds was much less and was repaired more quickly than damage to the industrial plant.

World agricultural production, on a per capita basis, soon exceeded the prewar level. Prices of farm products, which had been relatively high, began to weaken.

World prices are especially important for a number of farm commodities which are particularly dependent on exports (Table 1).

TABLE 1. UNITED STATES AGRICULTURAL EXPORTS: VALUE BY COMMODITY GROUPS AND PERCENT EXPORTED, 1959-60

Commodity Group	Exports (Millions of Dollars)	Percent of Production Exported
Wheat and wheat flour	875	48
Cotton, excluding linters	826	44
Animals and animal products	583	3
Vegetable oils and oil seeds	546	36
Feed grains, excluding products	543	9
Fruits and vegetables	400	13
Tobacco, unmanufactured	342	29
Rice, milled	136	56

SOURCE: Foreign Agricultural Trade Outlook Charts, 1961.

The United States, along with many other countries, elected not to follow the world-wide downtrend in prices of major export crops such as wheat, rice, and cotton. For these crops we chose to divorce the domestic price from the world price, and to reach the world market through an export subsidy. The effect of this policy, so far as foreign trade is concerned, has been to shift the impact of farm price supports. Were it not for the subsidy, the effect would be felt very quickly in the form of reduced export sales and sharply reduced acreage. With the subsidy, the effect is more dispersed and shows up in the form of increased program costs, increased need for protection against imports, and encouragement to other countries to raise their support prices.

We not only divorced ourselves from world prices on certain crops; we also elected to escape from restricting our exports to what could be sold for dollars. In 1954 we enacted Public Law 480, which provided that surplus farm products could be sold for foreign currency, donated to needy people, and bartered for strategic materials.

We thus escaped, for major farm export crops, two of the most powerful forces which discipline international trade: competitive

prices and the availability of foreign exchange. With this help farm exports increased from less than 3 billion dollars in 1953 to nearly 5 billion dollars in 1960 (Table 2).

TABLE 2. UNITED STATES MERCHANDISE EXPORTS AND IMPORTS, AGRICULTURAL AND NONAGRICULTURAL, 1953-60

Year	Exports			Imports		
	Agri-cultural	Nonagri-cultural	Total	Agri-cultural	Nonagri-cultural	Total
			Billions of Dollars			
1953	2.9	9.4	12.3	4.2	6.8	11.0
1954	3.1	9.7	12.7	3.8	6.6	10.4
1955	3.2	11.0	14.2	4.1	7.4	11.5
1956	4.2	13.0	17.2	3.8	9.0	12.8
1957	4.5	14.8	19.3	3.9	9.4	13.3
1958	3.9	12.3	16.2	4.0	9.0	13.0
1959	4.0	12.2	16.2	4.0	11.3	15.3
1960	4.8	14.5	19.4	4.0	10.7	14.7

SOURCE: Economic Report of the President, 1961.

Recovery of World Industry, and Policies Not Yet Resolved

The recovery of agriculture in the war-devastated lands was followed by the recovery of industry. Japan and the countries of Western Europe now are modernized and retooled, vigorous, and competitive. Whereas for a substantial period following the war we had a clear advantage in the availability, quality, and prices of our manufactured exports, we now find that we are challenged in all these respects.

This should not come as a surprise. It is the result of their work and our help, as planned. What we face, in fact, is the success of our past policies. These objectives have been achieved:

Our allies have become economically strong. As one result of this strength, better overseas markets exist for American export products.

Our friends in Japan and Western Europe have held off the threat of Communism and are sturdy members of the community of free nations.

Currency convertibility, which greatly simplified the conduct of trade, has generally been resumed by our major commercial trading partners.

Many trade barriers have been reduced, permitting an expanded flow of trade with resultant mutual diplomatic and economic benefits.

Clearly, with our earlier objectives attained and with new hazards confronting us, we must take our bearings and lay our plans for the next stage of the journey.

What are the new problems that confront us, what are the new foreign trade objectives which we must define, and what are the alternative tactics we might pursue?

But first a word on the meaning of these questions to farm people.

The Farmer's Stake in Trade Policy

Farmers who produce the price-supported crops might be tempted to dismiss foreign trade issues as unimportant. With the help of a subsidy they get their export crops into the dollar market. With the help of Public Law 480 they get their products into the countries which do not have dollars. With the help of quotas the government keeps out the dairy products, the cotton, the wheat, feed grains, and special crops which would otherwise be attracted to the United States market.

True, for about 40 percent of U. S. farm export products, the old disciplines of competitive price and dollar availability still apply and are very real. But about 60 percent of our agricultural exports now move out of the United States with some form of government assistance.

The farmer's concern with foreign affairs thus has shifted somewhat. He is still interested in the conventional problems of foreign trade specifically as a farmer, though less so than formerly. But he is increasingly interested as a citizen. This results from the growing importance to all citizens, in a tinderbox world, of international affairs of all kinds.

This paper, therefore, will deal primarily with the general problems of foreign trade as they affect all of our citizens.

FOREIGN TRADE OBJECTIVES

The general objectives of foreign trade policy for the years ahead appear to be these:

1. To safeguard and strengthen the community of trading nations of the Free World to provide a strong bulwark against the Communist threat.
2. To win growing overseas markets for the abundant products of American farms and factories.
3. To obtain for our citizens the higher levels of living which come from international specialization and exchange.
4. To earn a sufficient amount of foreign exchange to permit us to meet our international obligations.

5. To provide reasonable safeguards against the market disruption which could come from sudden and sharp increases in the supplies of certain goods imported into the United States.

The general objectives are not too different from those we have pursued in recent years. But in trying to achieve them, we face a new set of problems.

FOREIGN TRADE PROBLEMS

The difficulties we confront all relate in some fashion to a major present focus of foreign trade policy—the balance-of-payments problem.

Increased Imports

With their industrial plants retooled and modernized, Japan and the nations of Western Europe are sending us a growing volume of manufactured products, providing stiff competition. From 1953 to 1960, our imports of merchandise from Japan quadrupled, and our imports from Europe almost doubled. Japanese goods of high quality and excellent design are being sold at prices which domestic suppliers cannot meet. European manufactured products arrive in increasing quantities. For some textile and steel products the increase has been very rapid.

This increase in imports, particularly when it hits an industry concentrated in a certain area, creates for us a difficult problem of idle plants and unemployed labor.

Concern about these imports, however, should be kept in perspective. Our merchandise exports have also grown, increasing from about 12 billion dollars in 1953 to over 19 billion dollars in 1960. In 1960 merchandise exports exceeded imports by almost 5 billion dollars (Table 2).

Total imports amount to only about 3 percent of our total production. Foreign trade, while vitally important to specific industries, is a small part of our total economic activity.

Private Investment Abroad

The average hourly wage in the United States, including fringe benefits, is about three times as high as in Western Europe. The contrast with Japan is even sharper, and with Southern Asia it is tremendous. The meaningful comparison, of course, is not wage cost per hour, but total cost per unit of output. Here the United States, with its efficient mass production, has an advantage on many items. But increasingly we are being challenged.

American industries, confronted with increased imports produced by foreign plants with lower labor costs, are countering by establishing

branch plants overseas. These branch plants supply the country in which they are located, ship to other countries such as those in Latin America, and often ship goods into the United States itself. In each case they supply markets with commodities which might have been produced in this country with American labor. Unemployment, already a problem, is thus aggravated in certain areas.

Direct private U. S. investment overseas has several effects on international finance. U. S. dollars that go abroad for investment cause a drain on our current reserves. Overseas, these investments represent American-held assets of considerable value, now totaling 30 billion dollars, a reserve similar to that long held by Great Britain. If earnings of these industrial plants are returned to the United States, they increase our receipts from overseas and ease our balance-of-payments problem. This has begun, and is well underway. A part of these foreign earnings, however, are reinvested in the countries where they were earned.

Responsibility for Foreign Aid

From World War II through 1959 the United States supplied 80 billion dollars of military, economic, and technical assistance to our friends overseas. For the year 1960 the figure was 4.2 billion dollars.

TABLE 3. NET U. S. GOVERNMENT OVERSEAS GRANTS (EXCLUDING MILITARY) AND U. S. DEFENSE EXPENDITURES OF U. S. ARMED FORCES ABROAD, 1946-60

Year	Overseas Grants	Defense Expenditures
	Millions of Dollars	
1946	2,274	493
1947	1,897	455
1948	3,894	799
1949	4,997	621
1950	3,484	576
1951	3,035	1,270
1952	1,960	1,957
1953	1,837	2,535
1954	1,647	2,603
1955	1,901	2,823
1956	1,733	2,955
1957	1,616	3,165
1958	1,616	3,412
1959	1,623	3,090
1960		3,000

SOURCE: *The United States and World Trade, Challenges and Opportunities,* Final Report to the Committee on Interstate and Foreign Commerce, United States Senate, by Special Staff on the Study of U. S. Foreign Commerce, March 14, 1961.

This aid first took the form of assistance to Japan and the industrial nations of Western Europe. With the recovery of these countries, we increased our assistance to the developing nations of Asia, Africa, and Latin America (Table 3).

This effort, undertaken to help the Free World counter the Communist offensive, gives sign of long duration and growing dimensions. To the degree that this aid is provided in the form of dollars, it calls for increasing American exports sold in an increasingly competitive market. The American export trade is taxed to its utmost to earn the dollars with which to finance this major outlay.

Of course, to the degree that help is supplied in *kind* rather than in *dollars* (wheat and machinery rather than gold and dollars) the balance-of-payments problem does not arise directly. It then becomes a problem of our productive capacity, our willingness to tax ourselves for overseas development, and our willingness to transfer a part of our real wealth to the developing countries.

Protectionism Abroad

While trade barriers have been gradually lowered throughout much of the world during the past quarter of a century, many obstacles remain to stunt export opportunities for American goods.

Certain mutual tariff reductions negotiated with the Europeans in past years were effectuated by the United States, but postponed by the Europeans because of the "dollar shortage." The reasons for postponing these trade liberalizations have disappeared but some of the trade barriers still remain, especially for farm products.

The European Common Market and European Free Trade Association, which plan tariff reductions among their member nations, are attempting to develop trading patterns favorable to their own members rather than to the Americans. Again, this is particularly true for agricultural products. In Europe, as in most countries, agricultural interests are protection-minded and politically powerful.

Most of the nations of Europe exclude large categories of Japanese goods. The result is that Japanese industrial products, denied a market in Europe, are disproportionately directed toward the United States. We absorb them, with resulting adverse impact on the American industries directly affected.

Travel and Service

Americans travel overseas in growing numbers, spending more than a billion and a half dollars a year, almost twice the sum spent by foreigners traveling in the United States. In addition, American

dollars are spent for foreign-owned shipping (which pays lower wages than American shipping). The outlay totals a billion and a half dollars annually, though this is offset in large part by the foreign exchange earnings of American ships and planes. These expenditures of dollars for travel and service, while educational and economical, constitute an additional drain on our reserves.

Flight of Capital

With the leading currencies now freely interchangeable, the movement of liquid funds from one country to another is easy. Foreign holdings of U. S. short-term liabilities have increased during each of the last 11 years and now total 19 billion dollars.

A change in the interest rate in one country relative to another, an upsurge in the market for stocks or bonds in one country as compared with another, or a wave of apprehension about currency devaluation may quickly deplete the reserves of a nation which, on a long-run basis, is in a sound financial position.

Balance of Payments

The balance of payments is the balance between overseas payments into and expenditures from our reserve fund. When expenditures exceed receipts our reserve is impaired. The whole operation may be likened to a checking account. The gold reserve is our cash balance, totaling some 17.5 billion dollars.

We deposit in this checking account what we earn from the export of goods and services. In 1960 the figures were:

	Billions
Merchandise exports	$19.4
Returns on investments	3.2
Travel (excluding military)	1.0
Services	3.7
Total	$27.3

We "wrote checks" against this account as follows:

	Billions
Imports of merchandise items	$14.7
U. S. defense expenditures of U. S. armed forces abroad	3.0
Governmental grants and loans	2.8
Private long-term investments abroad	2.5
Travel	1.7
Services	3.9
Other dollar outflow (net)	2.5
Total	$31.1

We "deposited" 27.3 billion dollars and "withdrew" 31.1 billion dollars. Payments exceeded receipts by 3.8 billion dollars, and our balance was lowered.

Not all the "checks" we write are cashed at once. They may be carried around for a time. (This is sometimes profitable since interest may be earned on them.) At some future date they will in some fashion be presented for payment. About 19 billion dollars of these short-term claims are held against our account by foreign countries, not counting about 5 billion dollars held by international organizations. The possibility that the holders of these claims might suddenly decide to cash them constitutes the *short-term* balance-of-payments problem.

The *long-term* balance-of-payments problem, on the other hand, is characterized by the persistent tendency, since 1950, for our payments to exceed our receipts.

Our gold reserve is still the largest of any nation, constituting 46 percent of the world's total. Our overseas assets, though not immediately available for settling our international account, constitute an enormous reserve. By comparison with the reserves kept by most other countries, our own are large. The redistribution of gold reserves during the past 15 years has permitted the re-emergence of convertible currencies, expedited trade, and up to this point has generally been in the interest of ourselves and our friends abroad.

Sizable needs are in sight for military and economic assistance to our friends overseas. Serious questions have been asked, at various times past, by overseas bankers concerning the soundness of the dollar. The dollar is now not only our own medium of exchange, but is also the reserve currency for the world. As leader of the Free World we have responsibilities beyond those of other nations and of earlier days.

While the redistribution of the world's gold reserve was wholesome up to a point, it should not be allowed to proceed beyond some point, difficult to determine but nevertheless real. Unless the trend is slowed and halted, we shall in time find that we lack the means for settling our international accounts. We would have to devalue the dollar, impose severe limitations on the international movement of capital, and practice the very restrictions on international trade against which we so long counseled the rest of the world. It is one thing for a war-devastated country to get itself into such a position. It would be another thing for the wealthy United States, recognized leader of the Free World, to slip into this condition.

We do not need to become panicky. We are a powerful and

productive nation. The problem is potential rather than current. It is embarrassing, troublesome, and awkward. If we take proper action, it need not become critical.

What alternatives, or what combinations of alternatives, are open to us?

ALTERNATIVE AND ASSOCIATED POLICIES

Many things could be done to overcome the adverse balance of payments and update our foreign trade policies. These fall primarily into two major categories, those that are *restrictive* in nature and those that are *expansive.*

Restrictive Programs

Restrictive programs are those which restrict the expenditure of dollars overseas. They would balance the account by cutting down on spending. Several alternative and associated proposals have been made. These are posed as questions:

1. Shut Down on Imports?

Reducing imports would save dollars, as we are so often told by those who desire protection against foreign goods. Imports could be reduced by increasing tariffs or imposing quotas, or both. Legislative and administrative means could be used to accomplish this. As imports were reduced, other things remaining the same, the trade imbalance would be redressed and the pressure on the dollar eased. (But other things would not stay the same, as we shall soon see!)

Sizable tariff reductions have been made. In 1932, before the Trade Agreements Act was passed, tariff revenues on dutiable goods imported into the United States equaled 59 percent of the value of imported goods. By 1958 the figure had fallen to 11 percent.

The contention is that this reduction has been too great, that foreign goods have flooded in, that American industry has been harmed, that the balance of payments has been placed in jeopardy, and that tariffs should now be increased.

Alternatively, it is proposed that quotas be established, voluntarily or by law, country by country, based on some historic pattern. The objective would be to reduce, or prevent a rapid increase in, imports of certain items.

Quotas interfere far more with trade than tariffs. Quotas mean the regulation, in some form, of individual business firms, while tariffs merely raise a barrier and leave the stronger firms free to climb over it. In time, a tariff becomes simply an invisible part of the cost structure; a quota requires continued and detailed administrative intervention.

Proposals for tariffs and quotas are put forward with vigor, not by those who are primarily concerned with the balance of payments, but by those who want protection against foreign produced goods.

But more is involved here than first meets the eye. If we were to raise tariffs or impose quotas, other countries almost certainly would retaliate. Since we now export 19 billion dollars of merchandise and import only 15 billion dollars we would stand to lose more from a tariff-boosting contest than we would gain. Furthermore, if we were to increase our trade barriers we would create dissension among the nations of the Free World and weaken the alliance on which so much depends. And we would be denying ourselves the efficiencies which come from international specialization and exchange.

2. Discrimination Against Low-Wage Countries?

Some people, fearing the competition of low-wage countries, propose that tariffs be established country by country, to equalize or partly overcome wage differentials. If this were done, the tariff on textiles from England would be rather modest, on these same goods from Japan much higher, and on textiles from India very high indeed.

These proposals run directly counter to the most favored nation principle, long our guidepost in international trade policy. This principle holds that any trading advantage given to one nation should be extended to all.

To impose a high tariff on a low-wage country and to adopt a low tariff for a high-wage country would deny markets to the developing countries and inhibit their economic growth.

If this proposal were adopted, international trade would become stratified. The wealthy nations would trade mainly with other wealthy nations, and the poorer countries would trade mainly with one another. The result would be a kind of economic caste system with the poorer nations kept on their side of the tracks.

A differential tariff would be in direct conflict with the first four of the foreign trade objectives listed earlier, and would satisfy only the fifth.

Of all the proposals offered, discrimination against low-wage countries is most out of keeping with sound economic principles.

3. Save Foreign Exchange by Domestic Procurement?

We might require procurement within the United States, of virtually all the commodities and equipment used in overseas economic development, used by the military, and used by our government here within our own country. Perhaps the largest dollar-saving opportunity in this list is the first, that is, requiring procurement within

the United States of materials used in our various overseas programs. Some initial steps in this direction have already been taken. (For many years this procurement has been largely on a competitive basis, internationally. As our competitive position has worsened the share supplied by American firms has dropped.) Other dollar-saving opportunities of a kindred nature include: cutting the amount of foreign goods which a tourist is allowed to bring into the country free of duty, reducing expenditures of dollars by military personnel stationed overseas, and shipping more of our merchandise in American vessels.

We have good reason, under present and prospective conditions, to provide our economic assistance in the form of commodities and capital goods which we ourselves produce, rather than in the form of dollars which the recipient nations might spend elsewhere. When we were trying to build up the reserves of our industrial neighbors, it made sense to allow the recipients of our aid dollars to spend them anywhere they wished. But now it does not make sense to give dollars to India, allow India to spend these dollars in Germany, and then have the Germans use these dollars to demand gold from our diminishing stock.

It may, in fact, soon be a choice between fairly large-scale assistance, specifying procurement in this country, or a restricted amount of help if we allow the recipients of our dollar aid to spend these dollars in any country they wish.

4. RESTRICT THE OUTFLOW OF PRIVATE CAPITAL?

To save dollars, we might clamp down on U. S. investment overseas. The building of American branch plants throughout the world would be slowed down. The outflow of dollars would be reduced and pressure on our gold reserve diminished.

No quick or general answer can be given to this proposal. Certainly we have reason to question the movement of American investment funds into developed nations, some of them "tax havens," which already have an abundance of capital.

American capital is needed, however, in the developing countries of Asia, Africa, and Latin America. We cannot escape responsibility for supplying a large part of it in some form. If we cut down on the movement of *private* capital, we may well have to supply this capital from *public* sources.

If we restrict the outflow of capital, American exports financed by this capital would drop. Restricting the outflow of private capital for balance-of-payment reasons is short-sighted. It is like trying to save wheat by prohibiting its use as seed.

5. Cut Back on Foreign Aid?

The size of the annual balance-of-payments deficit has been roughly equal to our annual outlay for economic and military assistance overseas. It is, therefore, often proposed that we correct the imbalance by sharply reducing or eliminating the mutual security program, better known as foreign aid.

This proposal, though popular with many people, fails to take into proper account the nature of the world in which we now live. We cannot survive without allies. We should nourish economic growth, representative government, and an enterprise economy in any nation where these institutions might grow and flourish. The operation will not be successful in all countries, and certainly the United States should not bear the whole burden. But the nature of the cold war is such that a sizable and perhaps a growing overseas commitment will have a strong claim on us for some years to come. It is in our interest to have our allies (and the neutral nations) strong economically and militarily. If they are strong, they will be less likely to accept the blandishments of Communism, or to capitulate to its threats.

We may encounter economic competition from the nations we help develop. But as they develop they will become better markets for American exports. A prosperous neighbor is a better customer.

Trouble is in store in a shrinking world, when the gap is widened between the "have" and the "have not" nations, particularly when the Communists lie ready to exploit the resultant envy and ill will.

To save dollars by wiser use of our foreign aid budget is wholly commendable. To try to save by cutting back or eliminating the operation would be "penny wise and pound foolish." And as has been said, assistance can be provided in kind if cash is scarce.

Another consideration is that if we greatly reduce or stop foreign aid, other countries almost surely would reduce their purchases from the United States. Thus, the balance-of-payments problem would continue, though perhaps on a diminished scale.

6. Devalue the Dollar?

Devaluation of the dollar would be an official act of the government, reducing the dollar equivalent from the present 13.71 grains of gold to a lesser amount. Expressed in another way, the government would raise the official price of gold from $35 an ounce to some higher figure. If other countries left their currencies unchanged, which is very unlikely, their exchange rates against the dollar would be altered, because the dollar would represent a smaller quantity of gold.

The purpose of these changes, if they were undertaken deliberately,

would be to put the United States into a better competitive position, pricewise, in world markets.

Some people say that we have "priced ourselves out of foreign markets." They claim that we have tilted the United States price level upward through lax wage policy, short-sighted administrative pricing on the part of some business firms, and indulging ourselves with cheap credit and unbalanced budgets. Inflation has made the U. S. market more attractive to foreign suppliers and has made it harder for us to sell overseas—hence the trade deficit and hence the case for devaluing the dollar.

While the flat and general statement that we have "priced ourselves out of world markets" has no firm basis, this is clearly the situation for certain commodities.

If a country's price level is high compared with prices in another country, prices in the two countries can be realigned (at least for certain commodities and for a limited period of time) by currency devaluation on the part of the high-priced country. The devaluing country cuts the gold content of its currency, thereby altering its exchange rate as related to the gold-based currency of the other country. If the other country leaves its currency unaltered, the devaluing country experiences, for a time and in terms of the other country's currency, a relative reduction in the prices of goods moving into and out of its area. The result is that goods can be more easily exported, and imports are not so strongly attracted.

Proposals that the United States devalue the dollar come chiefly from gold-producing countries which would stand to gain from an increase in the United States price of gold.

What can be said about appropriateness of devaluing the dollar? We can say simply that this remedy probably would not work. If we were to devalue, in all likelihood many other countries would follow suit at once. Exchange rates would be the same as before, relative prices would be unchanged, and the only countries to benefit would be those with gold to sell, among them the Soviet Union. Another group which would gain are the speculators who had bought gold in anticipation of devaluation.

Currency devaluation, undertaken deliberately, borders on economic warfare. Undertaken of necessity, it is an admission of failure to discipline the balance of payments. It is a remedy of last resort.

The United States is the recognized leader of the Free World. The dollar is the world's reserve currency. We cannot, with the responsibilities now upon us, abdicate our leadership and become a disruptive rather than a constructive influence in the world economy.

Programs for Trade Expansion

The foregoing proposals are generally restrictive. Proposals of a more constructive nature have in common a desire to correct the trade imbalance by expanding rather than restricting our overseas operations, by positive rather than negative programs. This is like a family which would wipe out its deficit by increasing income rather than reducing expenditures.

Programs aimed at expansion might be of several types.

1. FREE TRADE?

The case for complete removal of trade barriers rests on the valid economic argument that, other things equal, maximum efficiency in resource use would be thus achieved. However, the argument ignores the economic and political difficulties of eliminating or sharply curtailing industries which have grown up behind a tariff wall.

The policy in the United States during the past quarter century has been to lower trade barriers gradually, on a selective basis, in cooperation with other countries, with provisions to increase barriers in cases of demonstrated injury. As has been shown, the effective level of trade barriers is now about one-fifth of what it was before the adoption of this policy.

A number of legislative and administrative stipulations check or counter the movement toward liberal trade policy:

Section 22. Legal provision (Section 22 of the Agricultural Adjustment Act) has been made for imposing fees or quotas when imports threaten to impair a farm price-support program. Were it not for this provision, any effort to support farm prices above the world level would divert foreign farm products out of the natural channels of international trade into this country, where they would displace American farm products from the market or themselves to into government storage. We would then be supporting not just United States prices but world prices. If prices of farm products are to be supported above the world level, then something like Section 22 is needed, not so much to help the farmers as to protect the government from intolerable costs.

The Escape Clause. If an industry can demonstrate to the U. S. Tariff Commission that it has been injured as a result of a tariff reduction, the Commission has legal authority to impose fees or quotas on the article in question. Relatively few industries have demonstrated such injury. Existence of the provision tends to check the zeal of those who would reduce tariffs sharply and provides a cushion against genuine cases of injury from import competition.

The National Security Clause. The law provides that when imports make us excessively dependent on foreign sources of supply for items critical to the national defense, fees or quotas may be imposed. By this means we build reliance on our own rather than on foreign sources of defense-related items.

Complete free trade would do away with all of these provisions, as well as with tariffs and quotas of a purely protectionist nature. Complete free trade probably has never existed. Few people would propose it in its pure form. The United States has probably moved as rapidly toward trade liberalization as public policy consideration would permit.

2. PROMOTE EXPORTS?

If we could in some fashion sharply expand our exports of goods and services, we would earn enough dollars to carry on the needed overseas programs and meet our other international obligations. This might be done by:

a. Applying strong government pressure to eliminate remaining unjustified restrictions on imports of American goods into other countries.

b. Increasing government services to exporters—digging out facts, reporting market prospects, and opening doors for American products overseas.

c. Making American manufacturers, many of whom have not thought seriously about export opportunities, aware of overseas markets.

d. Providing certain additional forms of government assistance, such as extending export credit insurance.

e. Promoting foreign travel in the United States, which is an exchange earner and in effect is an export of American scenery.

These proposals have merit, and to a degree have been adopted. But more remains to be done. Until recently we have been under no particular pressure to earn foreign exchange. A concerted effort would uncover many opportunities.

3. GET THE OTHER DEVELOPED NATIONS TO PAY FOR DEFENSE AND ECONOMIC DEVELOPMENT?

Japan and the nations of Western Europe have growing economic strength and growing reserves of gold and dollars. With these resources they are now picking up a larger share of the cost for defense and development of the Free World. But they have gone only part of the way.

As these nations take over a greater share of this load, the United States burden would be correspondingly eased, and pressure on the balance of payments would be reduced. It would also make clear the broad nature of responsibility for the defense and development of the Free World.

But we should not delude ourselves. Even though we succeed in getting the other countries to pick up a bigger share of the cost, the load on us will probably remain large.

4. Renew the Trade Agreements Extension Act?

This act, often called the Reciprocal Trade Agreements Act, is the authority under which the United States has cooperated with other countries since 1934 in mutual tariff reductions. Under this act specific duties have been, on the average, more than cut in half. Meantime, price levels have more than doubled. Hence, as has been said, effective tariff duties now stand at less than a fifth of their earlier level.

The Trade Agreements Extension Act is scheduled to expire in 1962. Already we have divided opinion about whether the act should be extended in pursuit of the liberal trade policies we have followed during the past quarter century.

The cause of protectionism within the United States is strong and growing. With the industrialization of the South, a major bastion of liberal trade is being weakened. Certain labor groups, though formerly oriented toward liberal trade, are having second thoughts. Certain industrial people, long protectionist, find added argument in the balance-of-payments problem. Farmers, in part relieved of the price and exchange discipline with regard to international trade, are inclined to defer the issue to others.

Some people contend that the case for extending the act is weak since the possible additional tariff reductions are small and that the major present impediments to trade are the quotas and bilateral agreements with which Reciprocal Trade Agreement provisions are not well-qualified to deal.

But the case for continued authority to negotiate tariffs with other countries is nevertheless a strong one. We need the machinery provided by the Trade Agreements Extension Act to protect ourselves from possible discrimination against the United States by the new European regional trading groups: the European Common Market and the European Free Trade Association. As leader of the Free World, the United States cannot afford to turn its back on the liberal trade policies which have helped the nations of the Western Alliance.

If the act is allowed to expire, tariff-making would again become the province of Congress, with all the protectionism and log-rolling that led us to the Trade Agreements approach in the first place.

5. Adjustment Assistance for Industries Injured by Imports?

Proposals have been made that injury resulting from imports be remedied, not by the imposition of trade barriers, but by federal assistance for reorientation toward alternative products.

For example, if imports of textile products were found to have injured the American textile industry, workers would be retrained for other employment. New industries would be helped to come into the affected area. Loans would be made at favorable rates and tax advantages offered. These activities would be undertaken at some public cost. Thus, the burden of economic change would be diffused over the population as a whole.

Adjustment assistance has not been popular, chiefly because people do not want to leave their trade and because they doubt the effectiveness of the adjustment programs. But the adjustment assistance route is constructive because it fits the concepts of economic growth, comparative advantage, and international specialization. To redress injury from imports by boosting tariffs means a permanent cost increase to the American public for the protected item; to provide adjustment assistance calls for a temporary added outlay (until the adjustment is accomplished).

If adjustment assistance is to be provided, a high rate of economic growth becomes very important. In order to accomplish the adjustment toward new industries, it is vital that new industries grow and develop.

6. More Trade With the Communists?

U. S. trade with the Communist bloc is restricted by legal and administrative provisions based on both security and nonsecurity considerations. These range from a total embargo on trade with mainland China, through partial obstructions to trade with the Soviet Union, to relatively liberal trade with Yugoslavia and Poland.

Our trade with the Communist bloc amounts to about one-half of one percent of our total overseas trade. Our trade with the Communist nations, even if completely liberalized, would continue to be small. They and we are large countries with similar natural resources. Hence we have relatively little need for trade with one another.

The Communist bloc has launched an "economic offensive," of which trade and aid is an important part. From 1954 to 1959, Communist trade with the Free World increased from 3.6 to 7.3

billion dollars annually. Meanwhile, Communist bloc "aid" to the developing nations rose from 11 million to 1,405 million dollars. For the Communist bloc, trade and aid are interrelated, both being basically political decisions made by and for the state.

Our own policies regarding trade with the Communist bloc represent an uneasy middle ground, not basically changed during the last decade, between further curtailing such trade and liberalizing it.

Those who favor liberalization point out the following facts:

Our trade restrictions in no real way prevent the Communists from getting what they need or selling what they wish. Trading opportunities are available to them with virtually all of the other nations. They can and do copy our machines and our methods. We might as well trade with them and gain what economic advantage we can. Any additional gold or dollars brought in by this trade would help our balance of payments. Any surplus food we could move would cut our storage costs.

Trade may be the bridge upon which international understanding is built. As nations trade they come to understand one another better and peace is a more likely prospect. The old quotation is invoked: "If goods don't cross boundaries, armies will."

On the other hand, those who oppose liberalization of trade with the Communists use these arguments:

The Communists would gain from increased trade with us; the prospect of gain is the reason for their recent emphasis on trade. We should do nothing that would result in improving the position of the Communist world, even if in doing it we might to some degree improve our own position.

We should avoid becoming dependent upon the state-trading Communist nations either as a source of supply or as a market for our products. They are unreliable, ruthless, and dedicated to wrecking our system.

Liberalization of our long-held position would be considered by the world as a Communist victory, since the Communists have sought it and we have resisted. Any possible gains to us from trade liberalization would be dwarfed by this adverse development in the propaganda battle. In fact, say some people, we should further tighten down our trade restrictions to show our sturdy resistance to the Communist trade offensive.

The question of more or less trade with the Communist world is perhaps primarily a diplomatic and a military question, with economic considerations clearly in a subordinate role.

The economist's answer to the question "More trade with the Communists?" is probably a weak "yes." But the tools available to the economist are not well fitted for supplying answers to questions that lie primarily in other fields.

7. Toughen Up on Wage and Price Policy?

Undoubtedly we were somewhat self-indulgent in terms of wage and price policy during the period when Japan and Western Europe were recovering from the war. Since our overseas competition was weak, we could and did become lax. This laxity resulted in wage increases that consistently and substantially outran productivity increases, administered price increases not justified by costs, government price-boosting programs of various kinds, and fiscal and monetary policies that fed the fires of inflation.

Japan and the nations of Europe were tougher in terms of wage and price policy than we were during this period. What we must now do, we are told, is to learn again to count costs, to resist unjustified wage increases and administered price boosts, and to follow responsible budgetary, fiscal, credit, and monetary practices.

The bulk of conservative economic doctrine favors this approach. We must be competitive pricewise, the argument runs, or we would isolate ourselves on a plateau of high prices.

The opposite view, widely held but not well demonstrated, is that we must have a certain amount of inflation in order to keep our economy growing. To apply the brakes to wages, prices, credit, and the budget in order to be competitive pricewise would, it is said, result in a considerable amount of unused capacity. We should not, we are told, allow 95 percent of our economy, our internal operations, to be disciplined by the 5 percent of our trade which is external.

The truth is that the United States experienced economic growth during the declining prices of the late nineteenth century, during the stable price level of the 1920's, and during the rising prices of the postwar period. And the rates of growth during these periods were reasonably similar.

For the United States to try to remove herself from the environment of world prices would be a long step toward economic isolationism. It would be better for us to help create a wholesome world environment in which we and other nations can participate jointly, with mutual benefits.

AMERICA MUST DECIDE

When a family considers what it must do about its receipts and expenditures in order to protect its bank balance, it brings under

review not only its prevailing habits, but every one of a large number of alternative behavior patterns. The same applies to a country. We can readily see that foreign economic policy involves, in one fashion or another, almost every aspect of American economic life.

And we should think about these things before an emergency arises. A family or a nation which considers its problem deliberately, while its reserves are still adequate, will make a better decision than a family or a nation which postpones review until the checks begin to bounce.

Some countries of the world live under the shadow of a chronic balance-of-payments problem. While they are not happy with the situation, they have learned to live with it.

For us, a balance-of-payments problem is novel, unique, and baffling because so many years have elapsed since we had to be concerned with such a situation. We need to recognize that having a balance-of-payments problem is rather normal for a country, just as it is fairly normal for a family to have problems with its bank balance. The difficulty comes, not from having a balance-of-payments problem, but from trying to live as if it were not a problem.

Liberal trade policies (which generally facilitated rather than restricted international trade) served us well during the years when our allies had a balance-of-payments problem. The present challenge is to make the necessary changes, within a liberal trade policy, that will permit us to redress our own imbalance. Having helped other nations overcome their problem, we should be able to muster the imagination and energy needed to overcome our own.

SUMMARY

Trade policy, like any other major undertaking, includes the objectives, the strategy, and the tactics. The objective is the goal. Strategy is the basic plan for reaching the goal. The tactics are the day-to-day operations within the strategic plan.

In trade policy, the goal, generally accepted and unchanged for generations, is the success of the free society.

The strategy of international trade, changed but slightly with passing time and not really at issue, is to reach the five objectives listed earlier.

The tactics, which change with new circumstances and about which there is much dispute, involve the six restrictive and seven expansive policy proposals listed as questions and discussed in this paper. To the writer, those proposals which looked to trade expan-

sion seemed in general more promising than those which involved restrictions.

The important point in trade policy, or in any policy, is to keep the goal, the strategy, and the tactics properly related to one another. Particularly must we be willing to subordinate the tactic (which is flexible) to the strategy (which is firm) and to the goal (which is fixed). We must not allow our enthusiasm for some tactic to result in treating it as if it were the goal.

TABLE 4. U. S. AGRICULTURAL EXPORTS, PERCENT WITH AND WITHOUT GOVERNMENT ASSISTANCE, 1953-60

Year	Competitive, for Dollars	With Government Assistance		Total
		With Subsidy, for Dollars	Non-Dollar Movement	
1953	65	21	14	100
1954	66	14	20	100
1955	61	13	26	100
1956	46	14	40	100
1957	36	23	41	100
1958	40	30	30	100
1959	43	22	35	100
1960	42	29	29	100

SOURCE: Foreign Agricultural Trade Outlook Charts, 1961.

TABLE 5. ESTIMATED GOLD RESERVES AND DOLLAR HOLDINGS OF FOREIGN COUNTRIES AND INTERNATIONAL INSTITUTIONS, 1949 AND SEPTEMBER 1960

	1949	September 1960
	Billions of Dollars	
Continental Western Europe	6.1	20.4
United Kingdom	2.0	4.8
Canada	1.6	4.0
Latin America	3.1	3.7
Japan	.3	2.0
Other Asian countries	1.6	2.3
All other countries	.7	1.3
International institutions	3.3	6.8
Total	18.7	45.3

SOURCE: Federal Reserve Bulletin.

TABLE 6. EXPORTS AND IMPORTS OF MERCHANDISE AND THE GROSS NATIONAL PRODUCT, UNITED STATES, 1946-60

Year	Merchandise Imports	Merchandise Exports	Net Merchandise Exports	Gross National Product	Imports as a Percent of GNP
			Billions of Dollars		
1946	5.1	11.7	6.6	210.7	2.4
1947	6.0	16.0	10.0	234.3	2.6
1948	7.6	13.2	5.6	259.4	2.9
1949	6.9	12.1	5.2	258.1	2.7
1950	9.1	10.1	1.0	284.6	3.2
1951	11.2	14.1	2.9	329.0	3.4
1952	10.8	13.3	2.5	347.0	3.1
1953	11.0	12.3	1.3	365.4	3.0
1954	10.4	12.8	2.4	363.1	2.9
1955	11.5	14.3	2.8	397.5	2.9
1956	12.8	17.4	4.6	419.2	3.1
1957	13.3	19.4	6.1	442.8	3.0
1958	13.0	16.3	3.3	444.2	2.9
1959	15.3	16.2	.9	482.1	3.2
1960	14.7	19.4	4.7	503.2	2.9

SOURCE: Economic Report of the President, 1961.

TABLE 7. HOURLY WAGES AND FRINGE BENEFITS IN MANUFACTURING INDUSTRIES IN NINE COUNTRIES, APRIL 1959

Country	Hourly Cash Wages	Fringe Benefits per Hour	Total Labor Cost per Hour
Italy	$ .35	$ .26	$ .61
Netherlands	.44	.13	.57
France	.47	.24	.78
West Germany	.54	.24	.78
Belgium	.56	.17	.73
Switzerland	.67	.10	.77
United Kingdom	.68	.10	.78
Sweden	.94	.14	1.08
United States	2.22	.46	2.68

SOURCE: *The United States and World Trade, Challenges and Opportunities,* Final Report to the Committee on Interstate and Foreign Commerce, United States Senate, by Special Staff on the Study of U. S. Foreign Commerce, March 14, 1961.

TABLE 8. U. S. TRADE WITH INDUSTRIALIZED COUNTRIES

Year	Japan		EEC Countries[1]		EFTA Countries[2]	
	Exports to	Imports from	Exports to	Imports from	Exports to	Imports from
	Millions of Dollars					
1953	680	261	1,501	1,049	1,025	992
1955	648	432	2,127	1,138	1,495	1,029
1957	1,234	600	3,198	1,547	1,859	1,804
1959	935	1,029	2,395	2,401	1,557	1,804
1960	1,328	1,149	3,437	2,263	2,277	1,608

[1] Germany, France, Italy, Netherlands, Belgium, Luxembourg.
[2] Britain, Sweden, Norway, Denmark, Austria, Portugal, Switzerland.

SOURCE: Same as Table 7.

TABLE 9. NET DIRECT U. S. INVESTMENT ABROAD, 1946-59

Year	Millions of Dollars	Year	Millions of Dollars
1946	230	1953	721
1947	749	1954	664
1948	721	1955	779
1949	660	1956	1,859
1950	621	1957	2,058
1951	528	1958	1,094
1952	850	1959	1,310

SOURCE: Same as Table 7.

TABLE 10. MAJOR U. S. GOVERNMENT FOREIGN ASSISTANCE, POSTWAR AND 1960

Type of Assistance	Total Postwar		1960	
	Billions of Dollars			
Net grants of military supplies and services		26.5		2.0
Other aids				
Net grants, less conversions	34.0		1.6	
Net credits, including conversions	12.0		.1	
Net accumulation of foreign currency claims	2.6		.4	
		48.6		2.1
Investment in four international financial institutions		4.9		.1
Total		80.0		4.2

SOURCE: Same as Table 7.

TABLE 11. BOOK VALUE OF U. S. DIRECT INVESTMENT OVERSEAS, 1959

Area	Billions of Dollars
Canada	10.2
Latin America	8.2
Western Europe	5.3
Other	6.0
All areas	29.7

SOURCE: Same as Table 7.

TABLE 12. UNITED STATES BALANCE OF PAYMENTS, 1946-60

Year	Increase (+) or Decrease (—) in Over-all Balance	Out-movement (—) or Inmovement (+) of Gold	Increase (+) or Decrease (—) in Foreign Holdings of U.S. Short-Term Liabilities	Increase (+) or Decrease (—) in Foreign Holdings of U.S. Govt. Long-Term Securities
		Millions of Dollars		
1946	+ 933	+ 623	— 310	
1947	+4,862	+2,850	—2,012	
1948	+1,006	+1,530	+ 524	
1949	+ 211	+ 164	— 47	
1950	—3,602	—1,743	+ 918	+941
1951	— 343	+ 53	+1,055	—659
1952	—1,092	+ 379	+1,169	+302
1953	—2,102	—1,161	+1,023	— 82
1954	—1,516	— 298	+1,210	+ 8
1955	—1,149	— 41	+ 579	+529
1956	— 968	+ 306	+1,409	—135
1957	+ 468	+ 798	+ 382	— 52
1958	—3,477	—2,275	+1,171	+ 31
1959	—3,862	— 731	+2,426	+669
1960	—3,800	—1,700	+2,100	

SOURCE: Same as Table 7.