CHAPTER 1

THIRTY YEARS OF TROUBLED TRADE

THE barriers which obstruct the flow of trade have been raised higher and higher in the years since the outbreak of the First World War. Governments have interfered, increasingly, with the movement of goods and services across their borders. They have sought to curb imports by increasing customs formalities, by raising tariffs, by imposing quotas and embargoes, and by controlling the supplies of foreign exchange. They have sought to force exports by depreciating their currencies, by paying subsidies, and by bartering goods for goods. They have sought to gain at the expense of their rivals in trade by entering into exclusive deals and by setting up preferential systems which discriminate among their suppliers and their customers. At the same time, they have permitted private traders to seek higher profits through cartel arrangements that curtail output, raise prices, and divide up the markets of the world. And, upon occasion, nations themselves have entered into agreements designed to benefit producers by cutting output and boosting prices to the detriment of those outsiders who consume their goods.

The existence of these devices is well known; their consequences are less fully understood. When one nation raises its tariff and when it imposes quotas on imports, it prevents the producers of other nations from selling in its markets. When it depreciates its currency and when it subsidizes exports, it gives its own producers an artificial advantage over the producers of other nations in the markets of the world. When it enters into an exclusive arrangement with another nation, under which each of them agrees to discriminate against the goods produced by everybody else, it obtains a favored position

which bars the producers of other nations from the markets concerned. When a nation sets up, within its own sphere of influence, a preferential trading system which discriminates against the other nations of the world, it denies to producers outside the system an equal opportunity to sell their goods. When a nation blocks the conversion of its own money into foreign currencies and compels those who have sold to it to accept payment, on a quasi-barter basis, in its own goods, it forces its products into their markets and keeps other products out.

In all of these ways, nations prevent other nations from obtaining the foreign exchange which they must have if they are to import the materials and machines which are essential to their economic development. Moreover, when an industrial nation permits its manufacturers to enter into cartel agreements which restrict the output and raise the prices of manufactured goods, and when a raw-material-producing nation itself enters into arrangements which are designed permanently to restrict the output and raise the prices of raw materials, it makes these goods and these materials scarce and costly and, to that extent, denies them to the other peoples of the world. All of these measures operate to limit the purchasing power of the nations against which they are directed, and thus to make it more difficult for such nations to expand their industry and to raise the planes of living of their peoples.

THE FIRST WORLD WAR

During the century that preceded the First World War, goods moved with relative freedom between the nations of the world. The traders of one country sold to those of another and bought from those of a third. No effort was made to achieve a balance in the trade between any pair of states. Goods and services, loans and investments moved around the circle until accounts were canceled out. The money of one country could be converted freely into that of another; rates of exchange were stable; currencies were tied to gold; balances were settled in gold. In each country, prices and production were continually adjusted to conform to changes in world demand. Diplomacy was concerned almost exclusively with political relationships; economic agreements were confined to treaties of commerce

and navigation; national interference with trade was limited to tariffs for revenue and for the protection of domestic industries. A complicated network of economic relationships, resting on the general acceptance of common principles and procedures, was centered in the financial market of London, extended by the freedom of British trade, and supported by British dominance of the seas. A world-wide economy, built on the foundations of political and economic freedom, was preserved through a century of relative stability and peace.

The foundations of economic liberalism were shaken by the First World War. The economy of Europe was disorganized; productive facilities were destroyed; channels of trade were broken; heavy debts were incurred. Nationalism and protectionism were stimulated by the revision of boundaries and the creation of new states. Economic and political uncertainty weakened devotion to principles that were once unquestioned. Governments assumed increasing responsibility for the direction of economic life. England gave way to America as the world's great creditor; the center of economic power shifted from the United Kingdom to the United States. But America lacked England's dependence on foreign trade, her tradition of freedom in international commerce, her habituation to the requirements of economic leadership. She was unprepared to assume the responsibility that came to her unasked.

THE STORY OF THE TWENTIES

Efforts were made, during the decade that followed the war, to repair the structure of the world's economy. The removal of barriers to trade and the establishment of equal treatment for the commerce of all states were promised in one of President Wilson's Fourteen Points. Improvement of the legal basis of commercial relationships, elimination of quantitative restrictions, reduction of tariffs, and general adoption of the principle of non-discrimination were subsequently sought in a series of international conferences. But the League of Nations, in its Covenant, did no more than recognize the desirability of equitable treatment in world trade. And the economic conferences, most of them held under its auspices, were uniformly disappointing in their results.

A monetary and financial conference, held at Brussels in the autumn of 1920, recommended that exchange controls be abandoned and other impediments to trade removed. A conference of ministers, meeting in Genoa in May 1922, failed in its attempt to prepare an agreement reducing barriers to trade and contented itself with a series of pallid resolutions favoring the negotiation of commercial treaties, the improvement of customs administration, the stabilization of tariffs, and the progressive elimination of prohibitions on exports and imports. A diplomatic conference, held at Geneva in 1923, with the limited objective of simplifying customs formalities, succeeded in producing a convention that was ratified by thirty states and came into force in 1924.

A World Economic Conference, held at Geneva in May 1927, produced a comprehensive report outlining a detailed program for the reform of commercial policies and recommending the general reduction of tariffs, the adoption of a policy of non-discrimination, and the elimination of quantitative restrictions, export subsidies, differential internal taxes, and special privileges to state enterprises. But the conference, composed of technicians rather than diplomats, lacked power to draw up a convention committing governments; and when its delegations returned to their homes, they found little support in public opinion for the recommendations that they had made.

The League then planned a simultaneous attack on quantitative restrictions and tariffs, calling a diplomatic conference to meet in Geneva to consider the first of these questions in October 1927. This conference produced a convention that would have committed its signatories, within six months, to abolish all import and export prohibitions and restrictions. But this commitment was accompanied by a broad escape, permitting the use of quota systems "for the purpose of protecting, in extraordinary and abnormal circumstances, the vital interests of the country." The convention was to come into force when eighteen countries had ratified; the number of ratifications never went beyond seventeen. The related negotiations for the reduction of tariffs were not opened until the Great Depression had supervened.

Some progress was made, during the twenties, in negotiating commercial treaties, in obtaining adherence to the principle of non-

discrimination, in improving customs administration, and in removing certain prohibitions on trade. But this was overshadowed by the increase of tariffs in Europe, in Asia, in Latin America, and in the United States.

In this record of failure, our own country was not without responsibility. On the one hand, we insisted that our allies repay the loans that had enabled them to fight the war. On the other, we raised our tariff, thus obstructing payment in the only way in which it could be made. We refused to join the League of Nations. If we had pursued a different course—canceling the war debts, reducing our tariff, and cooperating fully in the reconstruction of the world economy—the efforts of the twenties might have borne more fruit.

THE GREAT DEPRESSION

The foundations of economic liberalism, badly shaken by the First World War, were all but demolished by the Great Depression. The gold standard disappeared; currencies were thrown into chaos; exchanges were subjected to national controls. There was a sharp contraction in the volume of the world's trade. The attention of governments turned inward; the issue of unemployment dominated domestic politics. Business recovery became the first objective of national policy; security of income and employment came to be valued above adaptability, efficiency, and progress in production. Governments assumed still further authority over economic life, controlling prices and output in the interest of domestic stability. Nations no longer permitted production to adjust itself to the requirements of a world economy; where national and international interests came into conflict, internationalism gave way. The world was unprepared to face adversity; each for himself and the devil take the hindmost became the general rule.

In February and March of 1930, the League of Nations held two conferences directed toward the conclusion of a tariff truce. The first of these meetings ended in failure; but at the second, eighteen countries, including the United Kingdom, Germany, France, and Italy, adopted a convention providing for a one-year truce, and twenty-three states signed a protocol which contemplated negotiations for the reduction of tariffs at a conference called to meet in

November of that year. The November conference was condemned to failure before it met.

In May 1930, the United States enacted the Hawley-Smoot tariff, raising duties to the highest level in its history. More than a thousand American economists protested this action, warning that it would "plainly invite other nations to compete with us in raising further barriers to trade," and all the major trading nations of the world informed our government that irrevocable damage would be done. The accuracy of these predictions was demonstrated in the next few months. Tariffs were raised in Canada, Cuba, France, Mexico, Italy, Spain, Australia, and New Zealand. Quantitative restrictions and exchange controls had been imposed by twenty-six countries by the end of 1931. The United Kingdom abandoned free trade and adopted a general tariff in February 1932. The nations of the British Commonwealth, meeting in Ottawa in the following summer, established the system of imperial preferences. As a part of this system, the mother country imposed new duties, raised others, and retained still others. The new arrangements became effective in October 1932.

THE STORY OF THE THIRTIES

A final effort to reach agreement for the reestablishment of order in international commerce was made in 1933. A Monetary and Economic Conference assembled in London in June of that year. The first problem that faced it was the stabilization of currencies. The pound and the dollar had been cut loose from gold; the relative values of different monies were unpredictable; sudden and violent changes created new hazards for international trade. Nations, accordingly, were unwilling to reduce trade barriers until monetary stability could be assured. But the United States, planning to stimulate domestic prices by devaluing the dollar, refused to commit itself. A message from President Roosevelt brought the conference to an end on July 3, 1933.

Intensive economic nationalism marked the rest of the decade. Exports were forced; imports were curtailed. All of the weapons of commercial warfare were brought into play: currencies were depreciated, exports subsidized, tariffs raised, exchanges controlled, quotas

imposed, and discrimination practiced through preferential systems and barter deals. Each nation sought to sell much and buy little. A vicious spiral of restrictionism produced a further deterioration in world trade.

Economic nationalism found its most complete expression in Nazi Germany under the leadership of Dr. Hjalmar Schacht. There the instruments of restriction and discrimination were perfected and put to work in the development of military power. The German trading area was cut loose, in large measure, from the markets of the world. Every foreign purchase and every foreign sale was subjected to totalitarian authority. Countries that sold to Germany were paid in marks that were useless elsewhere in the world. They were compelled, therefore, to buy from Germany. Weaker countries, supplying materials to build up the stock piles of the Reich, were forced to take their pay in high-priced goods and in goods for which they had no need. Dependent economies were exploited ruthlessly. The end of the road down which restrictionism leads was reached, under Hitler, by Nazi Germany.

The only light that relieved the gloom of the decade was afforded by two significant developments. The Reciprocal Trade Agreements Act was adopted by the United States in 1934 and some twenty agreements were concluded in the next five years. A Tripartite Agreement, stabilizing the rates of exchange of the dollar, the pound, and the franc was concluded by the United States, the United Kingdom, and France in 1936 and was later adhered to by Switzerland, Belgium, and the Netherlands. But these events were overshadowed by the threat of war.

THE SECOND WORLD WAR

Such was the unhappy story of international economic relationships in the years between the two world wars. The return of war, with its necessities and its compulsions, tightened the hold of governments on the world's trade. The channels of trade were broken by hostilities; where they were not broken, they were altered to meet the requirements of war. The United States, as other countries, engaged in economic warfare as a supplement to military warfare: we bought goods that we didn't need to keep our enemies from getting

them; we supplied goods to other countries to obtain from them the things we did need and to insure ourselves of their support; we denied goods to other countries to penalize them for not cooperating with us and to prevent them from aiding our enemies. The vast quantities of goods that moved across our borders were designed, in large part, for military use. International trade, throughout the world, became an instrument of war.

The Second World War was far more serious in its consequences than the First. It came upon a world already weakened by war and depression. It was fought, for six years, across two oceans and on three continents, with a destructiveness that had never before been known. Two important industrial countries—Germany and Japan—were knocked out of production. Elsewhere in Europe and in Asia, centers of industry were laid waste. Plant, machinery, and equipment were destroyed, stolen, or undermaintained. Transportation facilities were demolished and services disrupted. Stocks of materials were depleted. Fields went for years unfertilized. Workers were killed, displaced, deported; they suffered from malnutrition, exhaustion, and disease; strength, skill, and morale were impaired. The normal flow of goods and services was interrupted; markets were lost; producers were cut off from former sources of supply. Economic disorganization spelled financial instability, inflation, and chaos in exchange relationships. The future was clouded and enterprise found little ground for confidence.

The United States came to occupy a peculiar position in relation to the other countries of the world. As production abroad declined, during and after the war, production here rose. We increased the size of our productive plant by nearly half, our physical output of goods and services by more than half. The United States, at the war's end, accounted for a third of the world's production and for more than half of its output of manufactured goods. And these facts were reflected in its foreign trade.

THE IMBALANCE OF TRADE

The United States, in 1947, shipped a third of the world's exports and took only a tenth of its imports. Our exports of goods and services amounted to $19 billion. Our exports of goods, at more than

$15 billion, were three to four times the figures reached during the twenties and five times those recorded in the years before the war. Our total imports, however, ran at only $8 billion. And this means that our exports exceeded our imports by $11 billion a year.

Such figures are impressive in themselves; but it is not until they are broken down into their component parts that one begins to realize just what they involve. For this general lack of balance was reflected in our trade in every category of goods and services and with every other region in the world. In manufactured goods, we sold five times as much as we bought. In services, we sold three times what we bought. In foodstuffs, we sold a third more than we bought. And even in raw materials, our sales were almost equal to our purchases. Our exports of merchandise outran our imports for Europe by $4⅓ billion, for Latin America by $1¾ billion, for Canada by $1 billion, for Asia and the Far East by almost $1 billion, and for Africa and the Near East by over $½ billion. Cuba was the only important trading country from which we bought more than we sold. We were in the position of selling everything to everybody and buying too little of anything from anybody, of being creditor to all and debtor to none.

As a consequence, the other nations of the world were unable to earn the dollars with which to pay for the quantities of goods and services that we were supplying them. This situation was variously described as a dollar shortage, a dollar famine, and a dollar crisis. But the words describe the symptom rather than the cause of the disease. The cause was to be found in the economic consequences of the war. The dollar shortage was a production shortage; the dollar famine was a production famine; the dollar crisis was a production crisis.

We have here the basic cause of the imbalance that came to afflict the world's trade: on the one hand, an extraordinary demand for American goods—not only for the materials, machinery, and equipment that we alone could supply, but also for the food and fuel that other peoples would normally have been producing for themselves; on the other hand, an inability to produce and ship to us in payment the quantities of goods that we stood ready and willing to receive. The consequence was a drain on foreign reserves of gold

and dollars that would have spelled bankruptcy if it had not been controlled. And so it was necessary for other nations to tighten restrictions on imports so that scarce currencies, instead of being dissipated in the importation of non-essentials, might be conserved for the purchase of the most necessary goods. It would have been foolhardy, in the circumstances, to do anything else.

As in any epidemic, disease spread from centers of infection and healthy organisms were attacked. Countries that had not been devastated by war, where man power, plant, and equipment were unimpaired and production was in full swing, still had no assurance of immunity. In many cases, such countries had normally bought more from the United States than they had sold here and earned their dollars by selling elsewhere in the world. But now they found themselves selling on credit or taking money they could not convert. As a consequence, they, too, were forced to husband their reserves of gold and dollars in order to fend off insolvency. And the way they did it was to impose restrictions on their import trade. In a world where currencies are inconvertible and goods are bartered for goods, it is difficult for smaller countries to follow the rules of liberal trade. In a highly integrated world economy, none but the strongest can take a wholly independent line.

POSTWAR RESTRICTIONISM

These years have spawned a multitude of new controls. Almost every country outside of the United States now regulates exchanges, requiring exporters to surrender their earnings of foreign currencies to the government and forbidding importers to spend foreign currencies without permission of the government. Many countries impose direct controls on their foreign trade, some of them forbidding exporters to sell without a license and most of them forbidding importers to buy without a license. Several countries conduct some part of their foreign trade through state monopolies, thus exercising complete authority over sales and purchases. In Europe, particularly, trade is conducted through a network of short-term agreements between pairs of governments under which each party undertakes to license the exportation to the other of certain quantities of certain goods and both parties undertake to minimize transfers of

currencies by making payments through clearing accounts in their respective national banks. It is required, moreover, that purchases and sales in each of these arrangements shall balance. And this means, in effect, that the trade of Europe and a large part of the trade of the whole world has been thrown back from the civilized economy of money to the primitivism of barter. The regimentation of the world's commerce has become virtually complete.

This is the situation. What can be done about it? The first step—and the most obvious one—is the promotion of reconstruction and recovery in Western Europe, the center, before the war, of half of international trade. Restrictionism and discrimination are the fruits of financial instability and extreme scarcity. As the countries of Europe get back onto their feet, as production is resumed and goods once more become available in adequate supply, the need for these practices will disappear. The second step is the conclusion of agreements committing nations to return, as soon as possible, to liberal principles and the establishment of an institutional structure under which trade can flourish and individual enterprise, throughout the world, can take a new lease on life in more normal times. For it is only by subjecting them to international control that we can really be assured that restrictionism and discrimination, even though rendered unnecessary, will not, in fact, continue to clog the channels of world trade.