



AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

FOREIGN TRADE IN THE MIDDLE OF THE TWENTIETH CENTURY

By George B. Alcorn

Foreign trade today is different from what it used to be. We all know what two World Wars and the Great Depression did to our domestic economy. For one thing it brought the government more into the game as an active participant rather than as a side-line referee. Furthermore, this new player in our domestic economy has the right, or assumes the right, to change the rules of the game. In foreign trade the game has become vastly more complicated because every government has entered the game, and each one is now making its own rules — at least so far as the game affects them. Perhaps this is an oversimplification but one cannot deny that foreign trade today is different from what it was in the nineteenth century, and largely because governments are now trying to control trade to their own national advantage.

APPROACHES TO FOREIGN TRADE DISCUSSION

Before discussing how and why foreign trade is different and why governments change the rules of trade, let us say something about the traders, the government, and even the people who talk about foreign trade.

FOREIGN TRADE HAS POLITICAL, ECONOMIC, SOCIAL, AND MILITARY ASPECTS. Most of you have observed economists attempting to explain foreign trade. Frequently they fail to convince or impress their audiences, largely because they attempt to explain foreign trade solely in terms of economics and sometimes only in terms of comparative costs. But the problems of foreign trade are not only economic — they are social, they are political, and they are military. Economic problems become social; social problems become political; political problems become military; and military problems in turn become economic and political, etc. What is most important, we are not prepared to say, because of changes over time. At one time military considerations may transcend the economic, social, and political aspects. At some other time the economic considerations may dominate, and at still other times social or political considerations may be more important. Usually one must

recognize a combination of considerations — economic, social, political, and military — in analyzing foreign trade. Failure to recognize all of these aspects in their proper degree of importance is a primary source of misunderstanding.

A MIDDLE GROUND FOR FOREIGN TRADE DISCUSSION. Another source of misunderstanding is the habit of classifying all discussants of foreign trade into two categories only: (1) “extreme protectionists” wanting no imports and (2) “free traders” into which class some economists are thrown and who are supposed to advocate no controls, no tariffs, “no nothing.” Perhaps when we make the classification this bluntly, many will challenge us, and yet much foreign trade discussion proceeds from such premises. I have yet to see any economist who advocates complete free trade devoid of any tariffs or controls. On the other hand, even my most ardent protectionist friends do see the need of having some foreign trade so long as it does no violence to their own particular interests.

INDIVIDUAL INDUSTRY POINT OF VIEW. In this connection we can make one blunt observation without very much exception and that is, practically everyone looks at foreign trade myopically as it affects them. Farm organization Resolution No. 3, for example, may ask for import quotas or higher tariffs, and Resolution No. 5 will ask for increased export subsidies. Even within a single industry we see seemingly conflicting interests with respect to foreign trade. The raisin industry wants an export subsidy, and the wine industry wants high tariffs on wine imports. Cotton producers want cotton exports subsidized and also want quotas on imports of long-staple cotton. Dairy products are disposed of in subsidized export markets, and restrictions are placed on dairy product imports. You may say that is inconsistent, but I say it is consistent from the point of view of the producer, which is that he wants to build and protect the domestic market for himself in the same manner that any progressive sales department does for its firm.

We must also remember that the foreign trade aspects of a single industry may look entirely different from the aggregate of a nation's foreign trade. Most academic discussion of foreign trade is concerned with the national aggregate of foreign trade while many actions of government with respect to foreign trade have to be specific with respect to individual industries. These

effects are sharply in focus so far as the particular industry is concerned. The effects of foreign trade adjustments upon the total national economy are not always readily apparent — particularly to an industry that may have been adversely affected.

GOVERNMENT: INDEPENDENT ACTION *vs.* PRESSURE RESPONSE. Another point we should make is that government is not entirely a paternalistic entity which decides objectively what is good for each and every industry quite apart from the noise and pressure developed by the industry. In a large measure government is not removed from the people, but various groups through their pressure obtain their own ends in the name of government action. Most of these actions are in the nature of restricting trade to the benefit of the pressure group. While this is true of a good many actions of government affecting particular commodities, there is also a considerable independence of government to these pressures. Over-all government foreign trade policy developed independent of individual pressure groups in the United States for about the last two decades has been in the direction of lowering trade barriers in order to obtain more trade.

NATURE AND DEVELOPMENT OF FOREIGN TRADE

Now before elaborating on the part played by government with respect to foreign trade, let us say a few words about the nature and development of foreign trade.

TRADING COUNTRIES NOT ALL HOMOGENEOUS. In the first place, trading countries are not all alike. Some countries are rich, some are poor, some are more dependent on foreign trade and some less dependent. Large parts of the world do very little trading. Eighty-five percent of the world's trade is carried on by the United States and its allies, while the U.S.S.R. and its satellites account for only about 15 percent of the international trade. Some countries like the United States are comparatively self-sufficient, but other countries' lifelines are dependent upon a large and constant volume of foreign trade. The United States, which produces about 40 percent of the world's manufactured goods, still relies predominately on home supplies of food and raw materials. In the last 100 years our imports have gone from a value of about 10 percent to 5 percent of our gross national product. This compares with about

10 to 30 percent for some European countries. Naturally these European countries will look upon foreign trade in a different way than we.

HISTORICAL DEVELOPMENT OF FOREIGN TRADE. We should say a word here about the growth and development of world trade. Historically it has never been a completely laissez-faire affair. If governments were not controlling it, pirates and bandits were. But in retrospect it appears that the growth of foreign trade began from some investment and banking center — London, for example — which provided the foreign investments and acted further as a world bank in providing acceptable foreign exchange. Amsterdam, Paris, and Brussels have also played similar minor roles in the establishment of the pattern of world trade. Now the United States assumes world leadership — and the investment and the banking role. After World War I large private investment loans were made. Now investments are largely intergovernment negotiated loans. Our great interest in world trade today is based not only upon economic considerations but also upon political and military considerations as well. While the United States today is economically less dependent upon foreign trade than many European countries, our new position of world leadership has caused us to assume the major role in establishing institutions for the revival and growth of foreign trade.

THE PROBLEM OF INDUSTRIALIZATION. We change our attitudes as our trade changes. Since about 1870 our imports of manufactured goods have gone down and our exports of manufactured goods have gone up. In other words, we became more of a manufacturing nation and less dependent upon raw material exports for trade. Now we are banging right up against one of the main problems in world trade. As more countries become industrialized, the pattern of trade changes: The relative terms of trade become less favorable to the industrialized countries. That is, an industrial country must sell a larger amount of manufactured products for the same amount of raw materials.

In the last century western Europe developed a large industrial economy which supported a large population based upon world-wide trade with countries producing raw materials and food. A large trade was made possible because of the

so-called "mixed economies," who could trade advantageously their complementary products. Today England, for example, complains about the lack of "mixed economies" — that is, the lack of raw material producing countries who will willingly buy English manufactured goods in exchange for raw materials.

Why have the raw material countries wanted to industrialize? For almost two centuries it has been commonly said that the terms of trade favor the industrialized nation. That is, the prices of industrial goods were high compared with raw materials. Two reasons are given: (1) the differences in the demand for raw materials and manufactured goods—lower prices on manufactured goods might increase sales appreciably but not so for raw materials and foods; and (2) differences in market structure which made possible some control of production in manufacturing but not of raw materials and foods — producers of manufactured goods, being relatively fewer in number, could control prices by controlling the volume of production. On the other hand, raw materials and agricultural products have been sold in a relatively unrestricted market so far as offerings were concerned, and most market adjustments were made in price changes rather than in restricted production. In times of depression, the raw material producing countries were very adversely affected, being subject to the full fury of economic adjustments, while the industrial countries could protect prices somewhat by decreasing production. On the other hand, in boom times raw material prices rise very rapidly, as happened after Korea.

GOVERNMENT CONTROL OF FOREIGN TRADE

Post World War I Period and the Great Depression

While World War II and its consequences definitely squeezed foreign trade into the mold of government control, we should mention two things that World War I and the Great Depression did to squeeze some of the trade into that mold.

OFF GOLD — UNSTABILIZED CURRENCIES. Either because of World War I or its consequences most of the major trading countries went *off the gold standard*. While this was not in itself catastrophic and perhaps necessary and desirable, it did complicate trade to the extent that while national currencies

were floating free of gold the time interval between sale, collection, and redemption introduced some further element of risk. In time, however, traders learned to trade without gold standards. The fact is, trade does go on in large volume in spite of the lack of gold standards and in spite of the dire predictions of a few die-hards.

MAINTAIN DOMESTIC FULL EMPLOYMENT. But the biggest squeeze on foreign trade came about largely because of the Great Depression. From the depression was evolved not only in the United States but abroad the policy that *government should strive to maintain full employment*. That policy has found expression in many acts of government. The desire of most governments is to protect their domestic employment or insulate their domestic economy from the vicissitudes of foreign trade. High levels of foreign trade are *not* a policy goal of government but a means to an end, which is full employment.

ADJUSTMENTS — EXTERNAL *vs.* INTERNAL. Let us say a few words about the type of adjustments now being made by government to changing foreign markets and conditions in contrast to those prevailing on the old gold standard basis and with less government control. In a sense the difference is between “internal adjustments” with rigid exchange rates under the old system as compared with so-called “external adjustments” with flexible exchange rates under the present nationalistic control system. Under the old system of very limited or no controls, changes in world conditions were reflected rather quickly in the internal economy, and domestic prices, production, and employment felt the full impact of the adjustment, while exchange rates remained steady. The new system that most countries are now attempting to follow in insulating their domestic economy is to take some of the adjustment in their exchange rates rather than all of it upon their domestic prices and employment. Suppose, for example, with the old rigid exchange rates British exports should drop in price on the foreign markets. This would be immediately reflected in lower domestic prices in sterling at home. Either production or employment would be decreased. But this is now contrary to the national policy of maintaining full employment; therefore, using flexible exchange rates, sterling can be devalued so that foreigners get more sterling for their

currencies, but since the prices of British exports remain more nearly the same in terms of sterling, employment and production are not as seriously affected.

This same objective may be obtained by the use of differential exchange rates. This is usually more practical and brings less complaint from other countries. Under the use of differential exchange rates purchasers of certain goods may receive more pounds sterling than the established rate which, of course, makes prices of these goods cheaper in foreign currency, which should stimulate the demand for them. Preferential or differential exchange rates have been used by a few countries to attract tourists.

The flexible exchange rate which changes the established rate of exchange affects all the foreign trade of a country — by reason of changing the value of the nation's currency in terms of other currencies. The differential exchange also changes the values of currencies but only on certain designated goods. (Blocked exchange means the acquired currency on that particular account cannot be freely converted into any other desired currency.)

But most countries have not been content to regulate their foreign trade entirely by manipulating exchange rates. Most of them have resorted to direct controls such as quotas, licensing, and embargoes. These usually supplement tariffs and, of course, affect only designated items.

Post World War II

THE PROBLEM AFTER WORLD WAR II. The titanic struggle of World War II left many countries, of Europe in particular, in a very poor position to trade — simply because it is one of the first prerequisites of trading that one must have something with which to trade. War-crippled economies, running a high fever of inflation, appeared to call for government control in most European countries. Sweden and Switzerland, the two neutrals, seemed free from the necessity of extended control, but a short, unlimited postwar luxury-buying spree was soon sobered up in Sweden by tight government controls. They became aware of the old proverb, "If you buy and buy, bye and bye you won't buy." Our own aid programs to ECA

countries also necessitated a certain amount of government control by the recipient countries.

THE SOLUTION — MORE GOVERNMENT CONTROLS. The obvious prescription for these European countries was to reconstruct their war-torn or capital-starved industries to enhance production and, secondly, to lower the feverish degree of inflation. These countries decided that this situation called for deliberate planning backed up by government controls. Like our own wartime economy, they did not think it feasible to rely entirely on the free market and the prices established there to integrate and regulate their economies — they would plan their way out. This meant that so far as foreign trade was concerned it would be controlled. So far as imports were concerned, they would get the supplies required by their plans and not the luxury goods that in a free-trade situation might be drawn into their countries by reason of the inflationary conditions existing there.

Having already obtained prewar experience in controlling foreign trade, the postwar experience was the postgraduate course. Tariffs and preferential tariffs are no longer the whole show. Quotas and embargoes, international agreements, blocked exchanges, differential and flexible exchange rates, and state trading have entered the picture. While all countries control foreign trade in some degree, there are important differences in degree — just like ice and steam. Russia, where practically all trade is carried on by the state, perhaps has the greatest degree of control while the United States perhaps represents the minimum of control. In many cases trade is handled by individuals but financed and controlled by the state. The impediments to trade are numerous but still trade carries on. Countries needed to trade, and bilateral agreements were resorted to in great number, but these agreements are simply an extension of internal plans of the respective governments.

THE DOLLAR SHORTAGE AND THE INCONVERTIBLE POUND. The dollar shortage and the inconvertibility of the English pound sterling perhaps deserve special mention here. A good part of the prewar world trade centered in payments being made in pounds sterling in London. The pound sterling could be converted into any currency and trade was greatly facilitated. London acted somewhat in the role of a "world bank" in that central banks of many countries kept their accounts in London.

Because of the near collapse of the United Kingdom after the war, the physical production of the United Kingdom was so low that the pound sterling would not buy much and, consequently, no one wanted the pound sterling. On the other hand, our production was up and the dollar represented a volume of goods and services and, therefore, the demand was for dollars. The United Kingdom, in order to conserve what dollars it had for strategic goods, refused to make the pound sterling convertible freely into dollars. Furthermore, it attempted to buy as much as it could from the sterling area, i.e., those countries whose currencies were based upon the pound sterling and were, therefore, willing to accept pounds sterling in payment for their goods. All of these arrangements plus our tied loans, i.e., requirements for purchases from the United States, of course, put trade into certain channels. The iron curtain, Korea, and "rearmament" also introduced new reasons for further control of trade by government.

INTERNAL CONCENTRATIONS OF POWER MAKE FOR MORE CONTROL. Thus, we enter the second half of the twentieth century with foreign trade greatly restricted and controlled as compared with the relatively free and unrestricted movement of the last century. Whether we like it or not, we must admit that trade is now more controlled. Foreign trade is controlled not only because of the war after-effects but also because our internal economy is different. The free forces of the market no longer operate as freely. Now we have big business, big agriculture, big labor, and big government all exerting their effects upon the economy. They no longer are willing to be left exposed to the full blast of the whims of a free world market. Big labor does not want to face the competition of free world markets; big business does not either, it wants its protection; big agriculture also wants its protection. Big government stands ready to help all three in their apprehension of the free markets — but in doing so it must in a degree control trade.

FREE WORLD MARKETS REPLACED BY GOVERNMENT NEGOTIATION. That brings us to a statement which we make even though it does need qualification, and that is—"In a sense there no longer is a world market." Years ago every school boy knew about the world market for wheat at Liverpool. Supply and demand there made the market. Now the price is made

by agreement between His Majesty's Government and the governments of Canada and Australia — supplemented by the International Wheat Agreement to which we belong. Under this agreement floor and ceiling prices of wheat are set for years in advance. Prices of many other agricultural commodities likewise become negotiated prices between governments. Strategic raw materials stockpiled by governments frequently are priced on a government negotiation basis. Wool after Korea was one notable exception but the decision of one government — ours — to cease stockpiling punctured the price advance completely. There never was such a thing as a world price for most manufactured items. A typewriter, an automobile, or even cigarettes, for example, would be sold in different countries at a range in prices wider than accountable for by transportation and other marketing costs simply because of the tax imposed or the subsidy enjoyed.

UNITED STATES ATTEMPTS TOWARD FREER TRADE

Perhaps we have overemphasized government's attitude toward controlling trade. Wars, depressions, and emergencies, most people — though not all — agree call for some degree of government control upon the economy. For two decades our country has had a program of attempting to lower trade barriers. Our country perhaps has less control over foreign trade and is more interested in free trade than any other country in the world today. Our program of bilateral and reciprocal trade agreements has been widened out into the General Agreement on Tariffs and Trade in which 38 countries are now committed to a policy of reducing trade barriers.

While other countries talk about expanding trade and lowering barriers, actually they have in some cases gone the other way. We should not condemn them because what they would like to do and what they actually do is different. Their internal economy demands that certain controls be used. There is an old saying, which has a certain degree of application here, and that is, "A poor man cannot afford to be thrifty." He is not in a position to buy in volume, to take trade discounts, to be free from interest paying, etc. Some of these "down and out" countries are like this poor man — they are forced to do certain things because they cannot do otherwise.

THE FUTURE OF WORLD TRADE

What about the future of world trade? No one can say very much with certainty. If we continue to live in a garrison state, a degree of control over trade will be inevitable, but after a time even with an iron curtain some trade filters through. On the other hand, if prospects of peace brighten, trade may be less restricted by government.

The increase in industrialization and the rapid growth in world population suggests to many that the terms of trade may swing the balance more in the favor of the producers of raw materials.

The atomic and synthetic age places new values on certain commodities which in turn will affect trade. The present premium rate on the Canadian dollar for the first time in history reflects our keen investment interest in Canadian oil and ore.

Few observers today see any immediate important decline in the position of governments with respect to foreign trade. In this country individual commodity groups, as in the past, can be expected to try to better their bargaining or selling position. In some instances, government appears as a hindrance to them. For example, few agricultural industries can point definitely to specific damage caused them because of the operation of any reciprocal trade agreement. Yet many agricultural industries facing foreign import competition at home would like to see the whole program abandoned. The reason, I suspect, is that they have less real pressure upon the negotiator than upon their respective congressmen. Further, they are on the defensive all the time in anticipation of changes which can be made by the executive branch of the government. They must stand prepared at any time to protect what to them appears to be their rightful share and protection in the home market. Many functions of government formerly performed by the legislative branch have been assumed by or transferred to the executive. Most observers feel doubtful that the process of changing tariffs and trade restrictions will be shifted back to the legislative branch.

In conclusion — it would be foolish to attempt to guess the pattern of future trade, but we can be reasonably sure that science, war, politics, differential rates of technological improvements, fads, and government will certainly change trade from the pattern that we used to know.