INTERNATIONAL ECONOMIC RELATIONS AND U.S. FOREIGN ECONOMIC POLICY

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COLONEL WATERMAN: You are about to hear one of the most basic treatments of the subject of "International Economic Relations and United States Foreign Economic Policy" that has probably ever been attempted. My approach is prompted by the belief that we have already had a pretty heavy dose of the complex and the technical in this area and we ought at some point to take time to look at the real fundamentals. Those here who have their Ph.D.'s in economics may find this a little bit oversimplified, but I believe that for the rest it will help a little to pull aside the veil of mystery that seems to shroud this subject.

The ramifications of the topic are so very extensive that I have had to put some rather severe limitations on the material and the aspects of it which I am going to cover. I am going to try to limit myself to doing four things.

First, I will show you what the advantages are of foreign trade which make it worth carrying on at all.

Second, we will have a look at some of the hindrances which make the conduct of this trade difficult and, incidentally, at the same time we will see what kinds of activities are included in the general term "international economic relations."

Third, I will develop the nature of our foreign economic policy, and, finally, I will discuss the relationship between international economic relations and economic potential.

The first question, which I believe we should start with, is: Why have international trade at all? Why should a nation make itself party to all of the aches and pains which arise from trying to trade with other countries? Wouldn't it be better simply not to sell to or buy from other countries and to confine our problems to the lesser headaches of keeping our internal economy in a healthy state?

Let us start with the premise that the primary urge which motivates people in their economic actions is the desire to improve their standard of living. Even such temporary diversions as armament are for the protection of that standard of living. Investment, too, is merely postponement of consumption in order to have even greater consumption and a better standard of living later on. Since people want primarily to improve their standard of living, they're going to do everything they possibly can to make their working efforts count for more goods and services.

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Let's see what contribution international trade makes toward this goal of an improved standard of living. The precept I am about to demonstrate is called "absolute advantage" in international economic terms. You will all note that the underlying bases for any economic system are what the classical economists used to call land, labor, and capital.

CHART #1 (Absolute Advantage)

You see that I have shown for three countries, England, Argentina, and China, their situations with respect to land, labor, and capital. Let us look for the moment only at this column, this one called "Factor Price." England is relatively short of land and has an ample supply of labor and capital. Therefore, in England you will find that the factor price of land, that is, the price per arbitrary unit, is high. The factor prices for labor and capital are lower.

In Argentina there is an abundance of land and shortages of both labor and capital. So here you will find that the factor price of land is low and those of labor and capital are high.

China, of course, has a superabundance of labor, a great shortage of capital and a great shortage of land relative to the pressure of the population on it; so that labor is very, very cheap for the arbitrary unit, and land and capital are high in China.

I have taken three commodities (see following table) of different kinds which require different amounts of the three factors--machinery, beef, and lace. You see for machinery that we require one arbitrary unit of land of some kind, 10 of labor, and 20 of capital. You will notice wherever you produce machinery that you require the same amounts of labor, land, and capital. Likewise with beef; you have a different combination of land, labor, and capital. But wherever you produce them you require the same amounts. The same with lace.

What I have done is to multiply the amount of the factor by the price of the factor in each country, getting the cost of the factor. Doing that to each product in each country, we find that England produces machinery more cheaply than the other two; Argentina produces beef more cheaply; and China produces lace more cheaply.

Well, you can see from these costs of production that if England, instead of devoting economic resources to producing a variety of products, concentrates on the one in which she is most efficient and trades for the ones in which she is less efficient, she will improve her standard of living. This way she will get more goods and services for the economic resources available to her. The same applies to Argentina in her concentration on beef, and China in her concentration on lace.

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Table 1. Absolute Advantage

	Factor price (dollars)	Machinery: Amt. of factor	Machinery: Cost per unit (dollars)	Beef: Amt. of factor	Beef: Cost per unit (dollars)	Lace: Amt. of factor	Lace: Cost per unit (dollars)
England							
Land	4	1	4	20	80	1	4
Labor	3	10	30	5	15	20	60
Capital	2	20	40	1	2	1	2
Cost per unit			74		97		66
Argentina							
Land	1	1	1	20	20	1	1
Labor	5	10	50	5	25	20	100
Capital	4	20	80	1	4	1	4
Cost per unit			131		49		105
China							
Land	5	1	5	20	100	1	5
Labor	1	10	10	5	5	20	20
Capital	5	20	100	1	5	1	5
Cost per unit			115		110		30

How about the case where one country is the more efficient producer of all products? I think I can show you that even in that case the more efficient country, by concentrating on the products in which it has the greatest comparative advantage and trading for the things in which the advantage is less marked, can improve not only its standard of living but the standard of living of those with whom it trades.

Table 2. Comparative Advantage

	Machinery		Textiles	
	Production cost (dollars)	Selling price	Unit Prod. cost (dollars)	Machinery equivalent
England	75		5	15 units
China	115	108	6	18 units

Let us again consider the case of machinery. England produces some unit of machinery, let's say a machine, for 74 dollars; China produces that same unit of machinery for 115 dollars. Now, let us suppose that in the production of cotton textiles England produces some unit of cotton textiles for five dollars per unit and China produces the same unit for six dollars. As you see, in machinery England is more efficient and in cotton textiles England is again more efficient. Now, if England wants to devote a certain part of her economic resources to the production of cotton textiles--let's say 75 dollars worth, the value of the production cost for one machine--she can produce for that 75 dollars worth of economic effort 15 units of cotton textiles.

Let's say instead of producing those 15 units of cotton textiles England goes ahead and makes machines at a cost of 74 dollars; it could sell a machine to China for some price between 74 and 115 dollars, depending, of course, on the relative bargaining power. Let us arbitrarily say the sale price of that machine to China is 108 dollars, which is not a bad buy for China and certainly is a good one for England. Assuming England takes its pay in cotton textiles, for 108 dollars of economic resources in China, China can produce at the six dollar unit cost 18 units of cotton textiles, which it swaps for the one machine. By that swap, both countries have improved their standard of living: England, because for 74 or 75 dollars worth of economic effort, got not 15 but 18 units of cotton textiles; China because it got the machine, not for the 115 it would have cost but for 108 dollars.

The obvious conclusion we can draw is that even when a country is the most efficient producer, it can, by concentrating on the products in which it has the greatest comparative advantage and letting others make those products in which the advantage is not so great, better its standard of living and the standard of living in the trading country as well. These examples, are assuming that each country involved in the trade had some amounts available to it of land, labor, and capital.

The argument for foreign trade becomes a great deal more forceful when only one of them has land of a certain kind. There are many things which are vital to our industry or to our present standard of living which are produced only in certain kinds of land or climates. There is virtually no way except by foreign trade for us to get such things as tin, manganese, certain agricultural fibers, coffee, or bananas. We can produce some of these things or substitutes for them here at home, but only at a waste of economic resources. We might very well grow coffee or bananas in hothouses here at home. But remember, I started with the premise that the object of our economic activity was to improve our standard of living, which means getting the maximum possible return for our economic effort. For those things which have no substitutes, foreign trade is an absolute necessity for the maintenance of industry.

Now that we have established the fact that international trade can be a good thing, beneficial to the standard of living of all concerned, let us ask why it is that obstacles are put in the way of it. First, let me give you a list of the common obstacles.

The first one is tariffs. That is the one Americans know best. Then there are import quotas, which forbid the importation of more than a certain amount of a given product; export quotas, which forbid the exportation of more than a certain amount; there are embargoes which forbid the importation or exportation of any amount; there are subsidies which enable the product at home to be sold more cheaply, even though the manufacturing cost is greater. There are foreign exchange difficulties; there are laws like the Buy American Act, with which I am sure you are all familiar; and there are many ingenious combinations of all these things.

Because there is so much confusion about the meaning of foreign exchange transactions, I am going to take a moment to explain their workings. International trade starts when someone with a product sees a chance to make a profit by selling it abroad. Let's say an English manufacturer sells his goods in the United States. The United States buyer has only dollars with which to pay for the goods. He can make payments by depositing his dollars to the Englishman's credit in an American bank. But remember that a dollar deposited in an American bank does not help an English manufacturer to pay his factory help or his taxes. But he doesn't have any trouble, because an English bank is always willing to buy that dollar deposit from him for sterling, for pounds. In that way an English bank acquires a dollar deposit in an American bank.

Let us take another case. Suppose an Englishman wants to travel in the United States. He needs dollars to cover his expenses while he is here. The English bank can sell him a draft on that American bank account that it acquired, for which he, the individual, pays pounds.

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He can then draw on that dollar account while he is in the United States. In such ways the dollar accounts owned by English banks in American banks and the sterling accounts owned by American banks in English banks continually rise and fall.

There are other kinds of transactions, too, which increase and decrease this ownership of foreign exchange. If Americans want to invest in French firms, they pay their dollars into American banks to the credit of French firms, who get the francs they need to operate by selling those American accounts to French banks.

If Americans ship in Norwegian bottoms or buy British maritime insurance, the dollar deposits of Norway, or Britain, in American banks, rise accordingly. If Americans have existing investments in Italian firms in which the dividends are to be paid in lira, the payments into Italian accounts of these American owners increase the United States holdings of lira.

If the United States gives other nations money, the grant is made in the form of a credit to the nations in American banks. These dollar balances owned by foreigners in American banks are available to purchase American goods and services and, as you will see later, almost any other country's goods and services.

All of this financial flow between a country and all of the other countries with which it trades results in what is known as a balance of payments.

Here is a table which shows the United States balance of payments. This is the balance of payments for the third quarter of 1951. These are not the actual figures, but they are pretty close in magnitude. I have done some rounding, in order not to get too involved with the actual figures themselves. (See following table)

The plus column represents increases in American holdings of currency. The minus column represents decreases in American holdings of currency. This column on your left shows you the actual composition of international economic relations, the kinds of activities that take place under that general heading.

First you see that the United States exported goods and sold services abroad. Of course those yielded plus bank balances. They imported some goods, purchased some foreign services, earned some income on existing foreign investments, and interest on loans.

Foreigners have money invested in this country on which they earn dividends or interest which represents dollar payments. During the quarter the United States and its citizens made loans and investments

Table 3. United States balance of payments 1455

Third quarter 1951

(millions of dollars)

	+	−
Goods exported	3,800	
Services sold	500	
Income on foreign investments	700	
	5,000	
Goods imported		2,600
Services purchased		100
Income earned by foreigners on U.S. investments		900
		3,600
Balance on Goods and Services	1,400	
U.S. loans and investments		
Private		200
Government		100
		300
Foreign loans on (investments to U. S.)	100	
Gold received		100
Gifts and grants		
Private		100
Government		1,000
	1,500	1,500

Not actual figures

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in foreign businesses and in foreign goods. Foreigners made some loans and investments in the United States during the quarter. This may come as a surprise to you, but it actually occurred.

The United States received some gold, for which it paid out currency. Then, there were gifts and grants, some by private individuals to individuals overseas and some by the government to foreign governments.

The important thing about the balance of payments is that it must finally balance. You have often heard of a favorable balance of trade. There is such a thing as an unbalance in trade, but the question of whether it is favorable is debatable.

So far as the balance in the balance of payments is concerned, if the quantities of goods and services, and the income earned on investments here, and the gold which foreigners send to us, are not sufficient to pay for the goods that we export and the services that we sell abroad, then there would be an unbalance. But that balance is automatically corrected, because, if the customer cannot pay, you have to give him credit. That credit will appear somewhere under loans. If he can't pay the loan, you write it off as a bad debt. Then it is a gift or a grant.

I show you this to point out that it is not possible to continue selling more than we buy, that the unbalance has to be corrected in one way or another, either by lending somebody the money to pay for the difference, or by giving it to him.

We know that the United States has consistently been selling more abroad than it has been buying and making up the difference by loans and grants. Let us examine why this is. Customers buy foreign goods only if they are cheaper or of better quality for the same price or if there are no comparable domestic products. Tariffs and subsidies have prevented foreign goods from being cheaper than domestic ones. Of course we buy large quantities of those things for which there is no comparable domestic product. I mentioned tin, manganese, coffee, bananas, and agricultural fibers.

The same is true with Europe. Europe does not raise enough food to feed its people, so it has to buy food abroad.

Before the war, the amounts of raw materials which we bought from the undeveloped areas, the amounts of machinery and manufactured goods that the undeveloped areas bought from western Europe, and the amounts of food that western Europe bought from us were such that around that triangle there was balance, balance in the payments.

The destruction of Europe's industrial plant during the war prevented it from selling manufactured goods to the undeveloped areas, and even compelled it to buy manufactures from us. A complete realignment of

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trade has taken place since the war. Foreign countries, taken as a whole, want more from us than we want from them, which was not the case in the old triangular arrangement of prewar days. That leads to a dollar shortage. If people want to buy more of our goods than they can pay for, of course they are short of dollars.

Why not trade in other currencies? Currency is meaningful only in terms of the goods and the services it will buy. I am sure that is no news to you. But I think if you will bear it in mind it will help you to see what I am trying to get across. The currency of a country represents claims on the goods and services produced by that country. People are interested in accepting it only if the country has the kinds of goods and services they want, at the prices they want to pay. They are glad to take United States dollars, because there's such a tremendous quantity of goods in this country on which they can spend those dollars. If they don't want to buy anything from us, they are still able to pay in dollars for goods purchased from some other country, because that other country will generally find some useful thing which it can buy in this country.

What is more, the United States is in a position to swap other currency, or rather bank balances in foreign banks, in return for United States currency. So we see the dollar is a convertible currency. Britain, on the other hand, does not have any such volume of goods and services from which a buyer can choose. Since it buys so much from abroad, it is more anxious to pay in its own currency than sellers are to accept that currency. A lot of countries have acquired pound balances during the war, for which they would like to get some goods. England cannot exchange its currency for their currencies, because it is not earning enough from other countries by its sales to them. It is therefore compelled to make its currency inconvertible, hence that much less desirable.

Obviously, the solution to currency difficulties and balance of payments difficulties as well is to find some way of selling more goods abroad, or to cease buying so much from abroad. It is pretty hard to reduce your purchases when so much of your food and industrial raw materials, as in the case of England, must be imported. Given a certain efficiency of production in a country, what is there to be done to sell more goods abroad? The answer, of course, is to cut prices.

There are two ways to do this--one is internal deflation and the other is depreciation of your currency with respect to other currencies. Deflation is a pretty painful remedy because it has the effect of depressing economic activity. Depreciation also has drawbacks but they are not so severe.

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Let us look at what England actually did. When the war ended, the pound-dollar exchange rate was four dollars and three cents because at some prior time this was the figure at which both English and American buyers thought they got a fair exchange of goods, considering prices in both countries. After the war, there was more inflation in Britain than there was in the United States. Buyers could no longer get a fair exchange of English goods for American goods. The British, of course, could get great bargains in American goods, provided they could sell us their goods. Naturally, they couldn't; so the English adopted a new pound-dollar ratio of two dollars and eighty cents. This does not change the price for local goods in England. It means, therefore, that Americans can now get more English goods in return for their American goods. It also means Britain has to pay more for its imports, food and materials, from the dollar area. The figure of two dollars and eighty cents was chosen as the best guess at a fair ratio between American goods and British goods.

Let me caution you right here that these remarks are a very considerable oversimplification of the problems of foreign exchange rates, but there is not time this morning for more detail.

I want to look at some of the other hindrances to foreign trade. Nations try to keep out the goods of other nations, primarily because local producers of similar goods cannot compete with the foreign goods. The remarks I made about the advantage of foreign trade would lead you to the conclusion that everyone will benefit if the more efficient producer is allowed to sell his goods wherever he wants. But you may have a new local industry just starting up which is now a high-cost producer and which promises to be a low-cost one when it gets on its feet. Of course people feel that it should be protected. That is what is known as the infant-industry argument. It is really astonishing how long infancy lasts for some businesses.

There also may be producers who got started in business when transportation was less efficient than it is now, and before the days of mechanical refrigeration, let us say. The United States dairying industry is a case in point. In earlier days it was probably the only possible supplier of most dairy products for the country. Now, with mechanical refrigeration and fast ocean service, the Scandinavian countries could probably provide us with cheaper dairy products. It's a funny thing; our dairymen don't seem to take a long-term economic point of view. They are not willing to suffer the consequences attendant on shifting to production of the things in which the United States is more efficient.

You know what happens. They bring political pressures; tariffs and other barriers such as quotas are put on, and they stay in business, at the expense, of course, of the American public.

Then there are industries which a country feels it must have itself, in the event of war. The best case in that connection is the shipbuilding industry. The Europeans in general can build and operate ships more cheaply than we can, but we say that we cannot afford to depend for our ocean shipping on Europe in the event of war. So our Government subsidizes shipbuilding and ship operation. 1459

There are countries which would normally produce only a very limited number of commodities but, because they fear the depression that would result from the drop in price of those commodities, they try to diversify. That introduces some inefficient industries, and the only way they can keep them alive is to protect them in some way.

Some nations which are unable to earn sufficient dollars to buy everything they would like, try to channel their dollars into the purchase of goods they deem most important to them. I haven't time to explain the exchange control gimmicks, but if you desire, I will attempt it in the question period.

I should not leave the discussion of hindrances to trade without some mention of bilateralism, the particular policy under which a country tries to strike a balance with each other country individually. This means that the volume of trade which takes place is reduced to the lowest common denominator. If country "A" wants only a million dollars worth of goods from country "B," country "B" is constrained to buy only a million dollars worth of goods from country "A," even though it would like to buy more. If you had multilateral balancing instead of bilateral, you would get the triangular effect which I described earlier, and, as a consequence, a great deal more actual trade.

So much for foreign trade. Let us turn now to the matter of the United States foreign economic policy, and I will try to show from whence it springs. Of course our actions in foreign economic policy have been shaped by our world position. We have never depended very greatly on imports. As a matter of fact, many influential people in this country have regarded foreign trade as simply the way for us to dispose of our own excess goods, so that we can have the benefits of mass production.

Throughout the country's earlier years it was growing very rapidly and there was demand for the protection of our infant industries; so we had a protective tariff policy. It was only natural we should do so. At the same time we needed and welcomed foreign capital to help in the growth of our industry and in the development of our own economic resources.

Remember that the Nation's foreign economic policies must have the same goals as national diplomatic policy. We choose our economic objectives so that they will support our national objectives. When the

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national objective was to remain free of entanglement in the quarrels and difficulties of foreign nations, our economic policy was one of aloofness. Now that we have come to believe that national security requires us to have friends, our economic policy is to maintain good relationships with those friends and to do what we can to strengthen them.

Our economic policy with respect to the enemies which we now recognize we have is to weaken them by economic means. Next week Captain Alexander is going to address himself to that aspect of our foreign economic policy.

The first big step in the direction of what I like to call enlightened economic relations was taken here in 1934 when Congress passed the Reciprocal Trade Act and we undertook a reciprocal trade agreements program. Since that time our policy has been to reduce the trade barriers, but always on a cautious, product-by-product and nation-by-nation basis. It seems to me that this reflects the conflicting attitudes of our statesmen who believe there are beneficial effects to foreign trade and our businessmen who insist on getting protection from foreign competition.

The change in our attitude toward economic conditions in the rest of the world came with the beginning of World War II. The first definite statement of American policy in this new direction is contained in the Atlantic Charter of 1940, which declares that all nations should enjoy equal access to the trade and raw materials of the world needed for their economic prosperity; that nations should collaborate fully in seeking economic advancement; and that all men should live in freedom from fear and want. The Lend-Lease agreements implemented this new attitude.

After the war the United States again recognized its responsibilities for the welfare of foreign peoples by its participation in UNRRA and its distribution of world supplies. In 1947 General Marshall, in his formal speech at Harvard, expressed the national policy anew. I would like to quote from that speech.

"It is logical that the United States should do whatever it is able to do to assist in the return of normal economic health in the world, without which there can be no political stability and no sure peace.

"Our policy is directed, not against any country or doctrine, but against hunger, poverty, desperation, and chaos. Its purpose should be the revival of a working economy in the world so as to promote political and social conditions in which free institutions can exist."

The next major pronouncement of economic policy was contained in President Truman's 1949 inaugural address in which he made four points of foreign policy. Point 4 introduces a new aspect of economic policy.

It proposes a new program for making the benefits of our scientific advances and our industrial progress available for the improvement and the growth of underdeveloped areas. Congress, in implementing Point 4, declared that the peoples of the United States and other nations have a common interest in the freedom and in the economic and social progress of all peoples.

Finally, Congress in the Mutual Security Act of 1951 declared it to be the policy to maintain security and to promote the foreign policy of the United States by authorizing military, economic, and technical assistance to friendly countries.

It is clear, then, that our policy has changed very remarkably from prewar days. Whereas 25 years ago we believed we should keep ourselves free of all entanglements, we now believe we should help the peoples of the world to improve their economic status. This policy is obviously based on both humanitarian considerations and defensive ones.

It has been pointed out from this platform that much of our international economic thinking is based on the notion that communism arises out of difficult economic conditions, and we assume that by improving economic conditions we can contain communism. It was suggested at that time that there are grave doubts whether this is really a valid conclusion. As I remember, two facts were cited as evidence.

First, Czechoslovakia, which was enjoying a fairly good state of economic stability after the war, fell to communism.

Second, western European Communist parties are still just as big after six years of our aid as they were at the end of the war.

It seems to me that these thoughts open up some tremendous implications with respect to our foreign economic policy. However, my function here is not to discuss the correctness of our foreign policy, but merely to let you know what it is and then to relate it to economic potential.

I should make the observation in passing that the triumph in Czechoslovakia was military and, in regard to the size of the Communist parties in western Europe, we don't have an adequate measuring stick by which to measure the results of our assistance, because we don't know what the strengths of those Communist parties might have been by now had it not been for our aid.

Well, it is not my purpose, as I said, either to defend or criticize our foreign economic policy. I am trying to suggest an apparatus, or, if you will, a way of thinking, which will help everyone to make his own analysis.

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Up to now I have described the theoretical advantages of foreign trade and some of the hindrances to it. I have told you what our foreign economic policy is and from whence it stems. I will now wind up the discussion with a description of what I see to be the relationship between foreign economic relations and economic potential.

In the first place I have already mentioned that most of the industrial countries are dependent in some degree on outside sources of raw materials, for both industry and food. The United States must import tin, copper, manganese, mercury, nickel, cobalt, industrial diamonds, hemp, jute, some rubber, coffee, tea, pepper, cocoa, sugar--you could name a lot more. The failure to get these things will make a tremendous difference in our economic potential, or, in the case of the luxury foods, in our morale. We could produce some of them ourselves. We might beneficate some low-grade ores. As I mentioned, we might raise coffee here, under hothouse conditions. We might synthesize some of the hydrocarbons, as we have done with rubber; but this is essentially a wasteful use of our economic resources. Any reduction in the efficiency with which we employ those economic resources available to us is per se a reduction in economic potential.

It also follows that whenever any commodity which can be produced more efficiently outside the United States is produced here, we are losing in efficiency, because we might devote those economic resources of our own to the things in which we are most efficient.

What about the value to our economic potential of our foreign economic activities other than this trade for industrial materials and food. Since the war we have laid out some 20-odd billion dollars in foreign grants and in loans. Some has been for military aid, but a great deal has been for economic aid. Under the Marshall Plan we have given western Europe about 12 billion dollars.

It seems to me that the proper question here, the question we should ask ourselves, is, whether we have gotten more for those 12 billion dollars than we would have gotten had we kept the money at home. That to me is the key question in this subject. Well, let's see. In the first place, if we had kept the 12 billion dollars at home, some of it would have gone to consumption. I think we can agree that it would have added very little to our economic potential. Certainly, we are well enough off in comparison with the peoples of other parts of the world so that this loss of consumption meant little or nothing to us.

Secondly, some of the 12 billion dollars may have been used for investment capital of one kind or another, either in the form of risk capital or loans to do anything we wanted to do to expand our plant. It is doubtful, had we expanded it more, if there would have been sufficient labor to staff this additional plant.

We know perfectly well in the third place that none of that money would have gone to our military establishment. If we had kept the money at home there might well have been starvation and revolution in western Europe, and it is possible Russia might now control the entire continent. If that is true, our twelve billion dollars have bought for the free world additional economic potential which may be measured by such factors as 200 million people with the highest level of technical know-how outside the United States, 45 million tons of steel production per year, and something like 150 billion dollars of gross national product per year.

This economic potential has also at the same time been denied to the Soviets, so that the swing, as the bridge players say, in terms of comparative economic potential is perhaps 400 million people, some 90 million tons of steel, and 300 billion dollars of national product--quite a significant amount.

Even if the things I have just suggested had not come to pass, I think there would be no quarrel with the statement that without our help there certainly could not now be in existence in Europe a military force of any consequence at all or any promise in the near future of any such military force.

Our technical aid to underdeveloped countries also has made some contribution to our economic potential. Some of the strategic raw materials come from these underdeveloped areas. Some of our aid has gone into further development of those sources of strategic materials. Whatever improvement we can make in the living standards of the people in these areas is certain to contribute to their well being and their ability to resist encroachment by any foreign power.

It does not seem to me on balance that we could possibly have bought as much economic potential for war by keeping this 12-billion-dollar aid to Europe and the proposed billion dollars of Point 4 assistance at home. I sincerely believe we have gotten a better return in economic potential by using the money as we did.

In summary, I hope I have proved to you now that a large volume of international trade is in fact beneficial to all the participants and that a certain amount of it is absolutely essential to our economic potential. I described what the hindrances are to foreign trade and why they exist. Perhaps some of the things I have said have contributed to your understanding of foreign exchange, too. I outlined to you the foreign economic policy and indicated the sources from which it comes and the reasons why it is what it is.

Lastly, I have shown you the relationship between foreign economic policy, international economic relations, and economic potential. Again I remind you I have avoided suggesting what actions we should take in the foreign economic field in the future.

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I would make just one statement in that connection. I do feel our general objective in foreign economic policy is to keep our friends strong and to make them self-sustaining. I emphasize "to make them self-sustaining." The means for accomplishing this end may in the future be entirely different from the means which we used in restoring war-ravaged economies.

I like to think that I am ready for your questions.

QUESTION: With reference to that 12 billion dollars, I wonder how much we did aid or relieve Europe. It seems to me it would have been better if we had kept the 12 billion dollars at home to balance the budget. We deprived ourselves by sending it over there. Economically it hurts us.

COLONEL WATERMAN: I would answer that question in this way. It seems to me that you are suggesting that over a period of six years the expenditure of 12 billion dollars would unbalance our budget. This I believe not to be the case. It seems to me the primary source of the unbalance in our budget has been the large military expenditure in Korea. We had a balanced budget after the war. If we had not found it necessary to devote large sums to our own military expenditures, the 12 billion dollars which we spent in rehabilitating the war damage in Europe would certainly have been no great strain on the United States budget. Is that acceptable?

COMMENT: Yes, but what I was getting at is, we have so much money I don't care whether we spend it for armament or not; but when we spend 12 billion dollars we come out with a deficit. Whenever we have a deficit it depreciates the dollar and touches everybody's income.

COLONEL WATERMAN: The only response I have is, after all, 12 billion dollars over the six years is something like two-thirds of one percent of our national product, which seems like a very small price to pay for the economic potential increase of 200 million people and 45 million tons of steel.

QUESTION: Can you tell us how that 12 billion dollars was transferred to those countries? What percent went in capital goods and mineral resources of our country and what went in food or things we can replace? It seems to me very little of the 12 billion which has been transferred overseas could have created work in this country.

COLONEL WATERMAN: It is true we created work in this country; I hope to have the exact distribution of that developed by the people who write individual reports on the Marshall Plan. Let me say this much: These dollars which were made available provided to western Europe the replacement machines and the plant without which it could not get its economy going. It doesn't make any difference whether that plant or those machines were provided by the United States or by somebody else who was able to make them. What is certain is that Europe itself was not able to make those things which would replace its capital plant. Therefore, if they were to get back on their feet, economically speaking, the machines had to come from some place.

COMMENT: The point I was making was, it seems to me that the Colonel also just referred to the fact that if we had kept that money we would have been better off. What I have been thinking is that we have not actually lost a great deal of our national wealth by making the loan or giving it to those countries; it all comes back when you consider the turnover in dollars.

QUESTION: May I see the chart?

COLONEL WATERMAN: Yes, indeed.

QUESTION: I would like to know what system you used in arriving at those figures in the first column?

COLONEL WATERMAN: My answer to you is it doesn't really make any real difference. What I am trying to show is, if a country has large supplies of capital and labor and little land, it can more efficiently produce those things which require large supplies of capital and labor and little land; and, if a country has large supplies of land and very little capital and labor, it can more efficiently produce those things which require a great deal of land and very little capital and labor. I chose beef and machinery for Argentina and England because I thought those would be accepted by the class as items which each of those two countries individually can produce more efficiently and which it would be better to trade.

Certainly you won't deny it would be most inadvisable for England to raise its own beef or make its own lace. You can get any result you want by assigning the values you choose for land, labor, and capital. I was trying to represent an approximately factual condition and I believe that those conditions with respect to the availability of land, labor, and capital actually do exist and that they produce those results with respect to differentiated products like those I picked.

QUESTION: Is it true that, although we have rehabilitated the facilities of Europe, the production, machines, plants, and so on, the trouble is that Europe has lost reserves of raw material and to a large extent the colonial markets on which basically Europe was dependent. Nations like Argentina have sought by industry to manufacture the articles they once got from England in exchange for beef. Isn't this pattern a factor that we have not considered yet?

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COLONEL WATERMAN: I think it is quite true that there is now some doubt whether Europe as of now is self-sustaining or can become self-sustaining; that is, whether it can earn enough by its production to buy the things it needs. What do we do? Do we simply write off Europe and let it starve? There has to be adjustment of some kind. I would hesitate to suggest what kind. Better minds than mine have attempted it and have not arrived at a solution. But I do suggest that we could go a long way to help solve this situation by creating conditions in which Europe could sell all of those products in which it is more efficient than we are. I am sure you have read in the paper recently about the action which this Government has taken to hinder the importation of European products which, if left alone, would sell.

The Italians put up a tremendous squawk on the quotas on such things as cheese, fur felt for hats, fur felt hats, and other things. The Italians could earn a substantial amount of dollars if they were left free to sell things in the United States. Our consumers would buy them. When you slap on an import quota or increase the tariff, you are raising an artificial barrier to their self-sufficiency.

I realize it is in some degree a theoretical argument and politics impinge on it; people want to do what they are doing rather than to swing to something in which they would be more efficient; but, there is a way in which Europe might be fairly allowed to earn its own way in the world.

QUESTION: Academically you have presented a very good justification for foreign aid. However, actually, I wonder what it has accomplished. France is producing, granted, more than it ever produced previously. However, current periodicals tend to imply that its position today is the worst since 1871. If this statement is true, it means that France is in a worse position after our aid than before, in spite of the fact that we have given it 5 billion dollars. Several periodicals I have read recently said France is bankrupt. They also stated that UK is practically bankrupt.

COLONEL WATERMAN: Well, I don't believe I should now engage in a complete discussion of the economic potential of France or any other country. But you have said that it is producing more than it ever did before. I said that with respect to the Communist parties existing, or perhaps with respect to other things about France, we have no measuring stick. We don't know what kind of shape it would have been in now had no aid been received. I don't want to dismiss your question but it seems to me the difficulty stems not so much from an economic situation as from the French psychology, the reluctance to pay taxes. I am sure you are all familiar with that. In other words the reluctance of the people to pitch in and do that which they as a country are now economically capable of doing.

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I didn't intend to bring in any discussion of how economic conditions affect psychology. We should all recognize that we have to consider psychology and morale as part of economic potential. But I simply say here what the academic explanations are. You called them academic explanations. What psychology does to these fundamental truths, let us say, is the subject of another lecture.

COMMENT: I gather from your discussion that the support of Europe has cost 12 billion dollars over the last six years. In that period the military forces of our land must have cost about 100 to 150 billion in those six years. I wonder, in your opinion, taking the national security objective into account as well, where have we gotten the most for our money, national security-wise.

COLONEL WATERMAN: It seems to me it is not a question of distinguishing as between economic and military aid where we got the greatest value for our dollar. The fact is that the two things, although they are interdependent in many ways, are still separate. Without the rehabilitation of western Europe's economic system, I think that military aid would have been entirely wasted. Again, without some military aid, the mere fact that economic systems have been rehabilitated would mean little or nothing to our total war potential. What I say is this: You have to do both. Unless you strengthen or rebuild the economy of a country, then military aid means nothing, because there is no business.

QUESTION: Bernie, I won't let you climb around the question that way. In making an evaluation or a judgment as to whether you should put more or less into military or other aid, it is a question of degree. In any allocation you have to make that judgment, it seems to me.

COLONEL WATERMAN: Maybe I am slipping around your question again. All of the examinations that have been made have shown that, regardless of what you do about military aid, you have to do something about the economy. Now, I doubt if there is any valid basis on which you can make a comparison of the exact worth of a dollar of military aid against the exact worth of a dollar of economic aid. I doubt it; that is an expression of opinion. You must have both and you might as well recognize it.

QUESTION: With reference to the previous question, I wonder if you could look at it in a different way and say it is an advantage to the United States, the 12 billion dollars that we have spent, rather than a charge to our European friends, as a substitute to our own exportations. If we didn't spend 12 billion dollars in that fashion, the producers of those goods being exported would lose that business; if we didn't have a surplus to export, it would mean a recession or cutback in this country. In the way of dollars, what we have in the foreign aid program, there is a difference of 12 billion dollars put in the balance.

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COLONEL WATERMAN: I think what you say is true; I doubt if it requires any answer. It certainly was a subsidy in some degree to American industry, because it was spent on American products.

COMMENT: My honest opinion is that we are a little selfish on the foreign aid program. I think we should look at it that way.

COLONEL WATERMAN: I think so.

COMMENT: I want to disagree. It seems to me that dollars have no value in themselves and that it is the real wealth, such as the capital, natural resources, and things like that, that you are shipping abroad. Dollars are merely symbols of wealth; they themselves are not wealth. Therefore, when we export what comes out of the ground--the coal, iron, steel, the goods that grow, the food--that is the real value that is going out of the country and not coming back.

COLONEL WATERMAN: It seems to me you are saying what I said to the Colonel. What we really are giving Europe, and what they needed, are our manufactured goods or our materials. On the other hand, I don't think that conflicts with the Colonel's approach or its result, in taking off our hands some of the goods which might have been surplus had they not been bought by those ECA dollars.

As you remember, I said something in my talk about certain Americans looking on foreign trade as a means of disposing of their excess products. In some cases, although foreign trade is a very small percentage of our total national income, it is a very substantial part of the total production of certain items. I am getting together some interesting figures which would show in certain industries a tremendous portion of the total production normally goes abroad. In those industries people are very interested in selling that by some means. Some nations must be able to buy our excess production or we can't sell it. That goes to show there are a great many ramifications to this problem, a great many factors, in many cases.

QUESTION: I was wondering about the market-place approach--that is, when a farmer takes his excess goods to market and he is pretty sure of disposing of them, unless he doesn't know what the price is. By multilateral do you mean that approach by which we have had a free market in the international trade? At the height of England's peak, in the nineteenth century, when England was on top, could a country be sure of selling all its excess goods somewhere in the international market?

COLONEL WATERMAN: Well, that seems to be a number of questions wrapped in one. I will answer the one about the free market by saying, no, there was never entirely a free market, for several reasons. One is such things as tariff. Another is such things as empire preference, in which Britain and the commonwealth countries had some restrictions which benefited their trade with each other and kept out some of the trade with outsiders. There has never been a free market. As to disposing of all the goods of which you would like to dispose, the farmer will sell those goods even when he comes down to the point where he is losing money. He has vegetables sitting there; if he doesn't sell them, they will spoil. Anything he can get for them is something. That is not entirely true here. Probably the answer to your question about being able to dispose of everything is no, it probably wasn't always possible to dispose of all the excess goods.

As to multilateral trade, I meant this; for example, we as a country did not worry about the fact that we had a deficit balance, let us say, with Costa Rica. We bought a lot of coffee from it; perhaps Costa Rica didn't buy much from us. We don't worry about having a deficit balance with Malaya. We buy a lot of tin and rubber from it. Malaya bought very little from us. It worked out for Malaya, Costa Rica, and a number of undeveloped countries. They took those dollars and spent them on goods manufactured in Europe. Europe in turn, which had a deficit balance with us, took the dollars from those undeveloped countries and paid for the deficit incurred with us. If we had simply traded with Europe and made the accounts balance, Europe could not have bought any more from us than we bought from it, which was darn little; but Europe was able to buy a great deal more of those things needed, one example--such as food, because of that triangular arrangement. That's what I meant by multilateral trade or balance.

QUESTION: Would you discuss foreign trade as a tool whereby a country can begin to tie to its allies, or to make a country dependent upon the primary country? I have in mind the situation such as Russia tying up with Yugoslavia and Czechoslovakia, making them dependent on Russia.

COLONEL WATERMAN: I can't give a very broad and general discussion on that in the couple of minutes available. In essence you have indicated how to go about that policy. It happened in the case of Germany; it's happening in the case of Russia. If a big country can become the sole customer of a small one for its products, it can pretty well call the economic tune for that small country; it ties the small country to it. Russia is doing it. It can compel the satellites to arrange production lines and order all they make as parts for machines. The countries are dominated by and tied to Russia.

The Germans attempted to set up what was in essence a mark bloc, in which they bought things from smaller countries and then held the balance in German banks, and the countries which owned those balances were unable frequently to buy with them. They are or were more or less trapped by having their assets in German hands.

There are many angles to this business of tying smaller countries to you. Does that suffice for now? Anything else?

QUESTION: Could you say something about the calculated risk we have taken in this sort of investment, and whether, if we had kept the raw materials and the productive instinct, which we have exported, to build up our own strength here, we might not have increased our strength.

COLONEL WATERMAN: I think it is evident that the calculated risk we took was our feeling that we could in fact build western Europe to a point where it can turn back the Russians before the Russians feel themselves capable of doing anything about it. If we were mistaken, then we were very badly mistaken; we have perhaps built some economic potential for Russia. But, at the stage of the game where all this began, we had to make that choice. The choice we made was to support Europe, to keep it from being overrun by the Russians. I am not better qualified to say what choice is more desirable than anybody else here is.

QUESTION: Referring back to the foreign aid problem of 12 billion dollars, as I understand it the foreign aid program and the success of it is generally tied to the counterpart fund. Under this each one of the countries has received funds to finance rehabilitation of the capital industries, which in turn would channel production into the country in exports, and so on, and which will permit the countries to buy more from us. I wonder if you will comment on the operation of the counterpart fund.

COLONEL WATERMAN: I am no expert on the operation of the counterpart fund. I doubt if an expert could make it very clear in two minutes. The actual need to loan American dollars, or give American dollars, is generated by the fact that Europe was not short of its own currencies; it was short of the ability to produce those things and those capital items which it had to have to get going again. The setting up of a counterpart fund, it seems to me, is just a little discipline on our part to make the European countries recognize that all this is not solely for their benefit but also to give them a means, as you say, of generating more production once they have received these capital items which they are unable to get elsewhere.

GENERAL HOLMAN: In the development of all this economic potential and international trade, particularly with reference to Europe, I hope that we don't lose track of the part that science plays in all of this--scientific changes, technology, and the progress in that direction--going back to any period you want, 1930, 1940, or since the war. One of the reasons Europe is not able to get back on its feet is because, as I see it, technology has moved so fast. Sure, Europeans could go back to the old methods of 1890 on weaving or on metal cutting, or anything like that, but there is a better way to do it. I think that enters into this problem a great deal in the economic considerations and certainly in the new methods of fighting a war.

COLONEL WATERMAN: Our time is up. Thank you very much.

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