CONTRIBUTION OF INTERNATIONAL ECONOMIC RELATIONS TO ECONOMIC POTENTIAL

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COLONEL WATERMAN: Admiral Hague, gentlemen: In the postwar years economic problems have occupied a considerable part of the spotlight in international relations. So much so, in fact, that it has become essential for anyone who would be well-informed to understand the nature of foreign economic relations and the issues which are involved in promoting them.

It is my purpose to explain to you this morning something of the composition of those international economic activities and to demonstrate why they are desirable. Further, we need to take a look at the reasons why, if foreign trade is desirable, we just don't go ahead and engage in it to everybody's satisfaction.

This talk, then, will cover four specific areas:

First, an explanation of the advantages to be gained from foreign trade.

Second, an examination of the kinds of activities which comprise foreign economic relations.

Third, a discussion of the mechanisms of foreign trade and the hindrances to it, and

Finally, a mention of American international economic objectives and their possible contributions to free world economic potential.

Many of my remarks may be subject to challenge on the grounds of oversimplification. But my objective is to explain these matters in such a way that everyone in this group can understand them, whether you have a degree in economics or not.

Let us begin with an examination of the benefits to be gained from foreign trade in commodities. Americans generally feel instinctively that the ideal is to sell as much as possible and buy as little as possible abroad. Let us see if this is really the best approach, purely from the standpoint of actual benefit to our people.

The object of all economic activity is the highest possible standard of living. Everyone tries to put his labor, his capital and his land to use in such ways as to maximize his return. We even pass up a part of our present standard of living in order to invest it in the improvement of the future standard. That portion of our income which is diverted from consumption to defense is merely a payment for protection of the standard of living.

We know that we can have more of everything if we specialize. In a primitive society, where a man grows his own food, weaves his own cloth, makes his own clothes and shoes, builds his own house, and performs most other services for himself, his standard of living is very low. As soon as specialization occurs, total output goes up. If one man concentrates on shoemaking, another on food production, another building, and they exchange their products with each other, there is a lot more in total to be shared.

This is just as true among nations as it is among individuals. If each nation specializes in producing the things which it can turn out most efficiently, and the nations trade their products with each other, every nation will secure more return for its economic effort than if it attempts to produce all its own needs. The ideal solution would be for each nation to produce those things in which it has an absolute advantage. Let me show you an example of this absolute advantage.

(Chart 1)

This chart depicts a hypothetical situation for England, Argentina and China in terms of the three factors of production--land, labor and capital. For the moment look only at the first column--factor price. This column represents the prices of a single arbitrary unit of exactly the same kind of land, labor and capital in a common monetary unit. These arbitrary units might be an acre of pasture land, a man-day of semi-skilled labor, and a machine-day on a common lathe--or other units--so long as they are the same in the three countries. In England, land is scarce and labor and capital are fairly abundant. In Argentina, land is plentiful and labor and capital are scarce. In China, labor is abundant and land and capital are scarce. Under these circumstances we may expect to find these comparative prices for the units of land, labor and capital.

Not let's look at the production costs for these three commodities. It takes the same quantities of each of the production factors to produce a unit of machinery, wherever you produce it. Let's assume that these quantities are one unit of land, 10 of labor, and 20 of capital. Beef takes much more land and very little capital or labor. Lace requires a great deal of labor and not much land or capital.

Now if we multiply the amount of each factor required by the unit cost of the factor and add the total costs of the factors, we can get the cost of production of a unit of each product in each country. We can see from these calculations that machinery can be produced most cheaply in England, beef in Argentina, and lace in China.

You can see from these figures that if each country concentrates on the products in which it is most efficient and trades for the others, everybody will get more of everything.

Now, how about the case where one country is more efficient than another in all products? Even in such a case, it will pay the more efficient country to concentrate on those things in which she has the greatest comparative advantage and to trade with the less efficient country for those products where the difference is less marked.

(Chart 2)

Let's look at two of our countries--England and China--again. This time we will talk about machinery and textiles. We assume that England is the more efficient producer of both products. Suppose the two countries produce a unit of machinery at the same approximate cost as in our previous case--$75 for England and $115 for China. Now we'll say that England produces textiles for $5 a unit and China for $6. You see that England has the advantage in both.

Now, if England takes the $75 worth of economic effort with which she might produce one machine and produces textiles instead, she gets 15 units of textiles. If, on the other hand, she produces the machine and sells it to China, she can get some price less than the $115 it would cost China to make it. Let's say that price is $108, which would be a good buy for China and a good sale for England. If, in payment, she takes Chinese textiles, she can get $108 worth, or 18 units. We see that by concentrating on machinery, England gets 18 units of textiles for her $75 worth of economic effort, instead of 15, and China gets a machine for $108 worth of economic effort, instead of $115. Both sides have benefited by the trade.

The evident conclusion from this example is that even when a country is the most efficient producer, it can, by concentrating on those products in which it has the greatest comparative advantage and letting others make those in which the advantage is not so great, better its standard of living and those of its trading partners as well.

In those cases where only certain countries are capable of producing particular products, the argument for foreign trade is so obvious as to require no elaboration.

Now that we have established that international trade is a good thing, beneficial to the standards of living of all who participate in it, let us ask why it is that obstacles are placed in its way. These are some of the obstacles we commonly find.

(Chart 3)

First, tariffs. The tariff is probably the obstacle most familiar to you. Our tariff system operates in two distinct ways to restrain trade. In the first place, the actual level of duties raises the prices of foreign products so that they cannot compete with domestic products, or so that the domestic demand for them is smothered. Secondly, the customs system has many complexities. An importer can never be sure how his product will be classified for tariff purposes. If he succeeds in creating a United States market for his product, some local manufacturer of a similar product may protest and cause the product to be reclassified or the tariff on it raised. It costs money to build up a market for an article. Foreigners are understandably hesitant about investing this money when the rug can be yanked out from under them by a change in the rules after they have succeeded in building their market. The English claim that in invading the American market, success invites extermination.

Our tariffs have a variety of purposes. Probably the original ones were for revenue only. Then came the theory that infant industries should be protected from foreign competition until they could establish themselves. There are those which protect industries which are admittedly uneconomical, but are considered necessary for defense purposes. Tariffs which keep out products yield no revenue, and, furthermore, it has never been part of the American tradition to stifle competition.

About three weeks ago Henry Ford, II expressed the opinion that the United States should eliminate all duties, including those on automobiles. He said that the auto industry would meet its competition in the market place, not in the halls of the Tariff Commission. This is an indication of the way forward-looking business men in this country are thinking. This particular case may serve as an indication of the effect that freer international trade might have on the standard of living. It would put the small European car within reach of a great many more people. There would be more two-car families and many people who do not now have a car might be able to afford one. Maybe you are thinking the same thing I am--8:15 on Maine Avenue; you would hardly need any more cars.

Other restrictions commonly in use in the world today are import and export quotas which limit the quantities of specific items permitted to enter or leave a country and embargoes, which bar any quantity of a product. As you will hear later on in a talk on Economic Warfare, the same thing applies to exports. We are primarly concerned with imports. Then there are the nationalist type of restrictions, the Buy American type of thing, which prevents certain public funds from being spent on foreign products unless there is a tremendous price differential; then you have subsidies which are payments to local producers which enable them to compete with foreign products; bilateralism, which I will mention later; finally, there are exchange restrictions such as inconvertibility of currency and multiple rates by which a country channels its supplies of scarce foreign exchange into the kind of supplies it deems most necessary for its economy.

If a nation is going to restrain foreign trade, the subsidy is perhaps the best way to do it, because then the taxpayer and consumer can identify specifically the payments he is making to protect inefficient industries from competition.

The principal reason which motivates a country to try to keep out the goods of other nations is the inability of local producers to compete with foreign made goods. Granted that this is counter to our whole philosophy of free competition, there may be some "legitimate" reasons for protecting domestic industry. In a newly developed country, such as this one was in the 19th century, we may have industries which are high cost in their infancy, but give promise of being fully competitive when they get established. The public will feel that they should be protected from the more mature foreign competition, and accordingly are willing to pay the price. This is what is known as the infant industry argument. Infancy has lasted astonishingly long for some businesses.

There are also industries which a country regards as necessary to have in the event of war and which it therefore wishes to keep alive despite their inability to compete. The case that comes immediately to mind in that connection is the shipping industry. The Europeans can, in general, build and operate ships more cheaply than we can, but we say that we cannot afford to depend on Europe for our ocean shipping in the event of war. So our Government subsidizes shipbuilding and ship operation.

There are countries which can produce only a few commodities competitively and are therefore vulnerable to severe economic upsets when the prices of these commodities fluctuate in the world market. Malaya, with its rubber and tin, is a case in point. Such countries are beginning to feel that they need other kinds of industry to damp down these fluctuations. The only chance of survival of these industries, under present conditions, is to have a tariff which will protect them from foreign competition.

There are producers who got started in business when transportation was less efficient than it is today. Take our own dairying industry. Before the advent of mechanical refrigeration and fast transoceanic travel, it was the only possible supplier of dairy products to the United States. Now the Scandinavian countries can provide us with dairy products cheaper than our own industry can. I don't include this case in the category of legitimate protection. But the dairymen have lost their taste for competition. They don't take the long-term economic point of view.

You all know what actually happens. They bring political pressures. Tariffs or quotas are applied, and they stay in business at the expense of the American public.

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In any discussion of the hindrances to international trade some mention should be made of bilateralism, which I skipped a moment ago. This is the policy of striking a balance with each trading partner individually. This usually involves a good deal of direct barter. When trade is conducted on a bilateral basis, the volume is reduced to the lowest common denominator. If Country A wants only a million dollars worth of goods from Country B, then Country B is limited to a million dollars worth from Country A, because they must strike a balance. If there were multilateral trading, each country could buy as much as it wanted from the other, so long as its accounts with all nations taken together were in balance.

Another type of interference with trade--the next one on my chart--arises from the efforts of certain nations to channel their supplies of scarce currencies into purchases of goods which they deem most important to their economies. These exchange controls are most interesting, but somewhat involved. There isn't time to treat them now, but if anyone desires, I'll be glad to do it during the question period.

There is a great deal of confusion about the workings of foreign exchange transactions. It's a subject important enough to devote a part of this talk to an explanation of how foreign exchange works. International trade starts when somebody sees a chance to make a profit by selling his product abroad. Suppose an English manufacturer decides to sell his product in the United States. Americans have only dollars with which to pay. The Englishman has no use for dollars. He must pay pounds sterling for his labor, his rent, his materials, his taxes. Dollars aren't going to do him any good for those purposes. But he has no trouble because an English bank is willing to give him pounds sterling in exchange for the dollars he earns. Willing? As a matter of fact they insist on it.

What happens? The American customer pays the dollars into an American bank to the Englishman's credit. The Englishman then sells the deposit to an English bank for sterling. Now the English bank owns the dollar deposit in an American bank--bear that in mind--and the Englishman has the wherewithal to pay his labor, his rent, and so on. In the same manner, American banks may acquire sterling deposits in English banks.

Let us take another case. If an Englishman wants to travel in the United States, he will need dollars to cover his expenses while he is over here. We have no use for pounds sterling--and I mean that. The English bank can sell him a draft in exchange for his pounds which will authorize him to draw a certain amount of dollars against its account in an American bank, thus reducing its dollar holdings.

This kind of rise and fall in the balances owned by banks of one country in banks of other countries goes on all the time.

In these transactions currencies do not ordinarily leave the countries of their origin. Everything is handled by the transfer of bank balances. If the United States grants foreign aid to a European country, it sets up dollar deposits in American banks to the credit of the particular country. That country then draws on this deposit to pay for goods and services which it buys in the United States.

Transactions of these kinds go on continuously in most of the world's currencies. As long as the demands for the various currencies balance out fairly well, everything goes smoothly and no obstacles to trade appear. But when they get out of balance, trouble arises. This out-of-balance condition is causing the world a lot of trouble today.

All of the financial flow between one country and all of its trading partners may be shown in a balance of foreign payments table in the country's currency. Here is the United States balance of payments, taken from the figures for the third quarter of 1951.

(Chart 4)

I have modified the figures slightly, in order to round them off and make them easier to understand. The items in the left-hand column will give you an idea of what types of activities are included in the term "international economic relations."

First, there are exports and imports of actual merchandise. Next, there are sales and purchases of services, which include such items as shipping, insurance and financial services, expenditures by tourists, and all kinds of personal services, such as engineering advice or legal counsel. I should add at this point that the plus column means that something has happened by which the United States earned currency; the minus column means that something has happened by which the United States created an obligation to pay somebody else currency. Then there are payments of interest and dividends on loans and investments which have previously been made in this country by foreigners or in foreign countries by Americans. When we balance these items off against each other, we obtain what we may refer to as a balance of trade, though this term is sometimes reserved for the balance on merchandise movements only.

Here are some of the other kinds of international transactions which take place. The United States Government and American citizens made new loans and investments in foreign countries totaling 300 million dollars. Foreigners made loans and investments here, believe it or not, amounting to 100 million dollars. And 100 million dollars worth of gold was shipped into this country. This is shown as a dollar outgo, since in effect, we were purchasing gold for dollars. Gifts and grants were made by our Government and our citizens in the amount of a billion, one hundred million dollars. This includes such items as money sent to relatives as well as our grants to foreign governments.

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Now you see that the balance of payments does in fact balance. It is possible to have an unbalance in trade, as you see. You have all heard the expression "favorable balance of trade," which means a balance on the plus side. But it is easily demonstrated that there is nothing favorable about it. Payments as a whole must balance, because if the exports of goods and services are not fully covered by imports, shipments of capital for investment purposes and shipments of gold, then the difference will appear as loans or gifts.

I point this out to show you that it is not possible to continue selling more than we buy unless we are prepared to give foreigners the money, either as grants or as unrepayable loans, to make up the difference.

Since the war, the United States has consistently sold more abroad than it has bought and made up the difference with loans and grants. Let us examine the reasons for this state of affairs. Customers buy foreign goods only if they are cheaper or of better quality for the same price than domestic goods. Tariffs and subsidies have prevented foreign goods from being cheaper here than domestic ones, or at least in part. Our large quantity imports are mostly items which cannot be produced in adequate quantities here.

On the other hand, certain conditions have prevailed in the rest of the world which compelled other countries to buy a great deal here. Europe, as you know, does not raise enough food to feed its people and it must buy food abroad. Most of the rest of the world is seriously underdeveloped and is incapable of making highly fabricated industrial products which their economy needs. Before the war, there was a neat triangular balance in payments. Europe sold the underdeveloped countries the machinery and manufactured goods they needed. We bought a lot of specialized raw materials--rubber, tin, cocoa, and many other things--from the underdeveloped areas. Those areas could use the dollars they earned from their sales to us to pay Europe for manufactured goods, and Europe, in turn, could use those dollars to buy food from us.

The war destroyed Europe's productive capacity and this left everybody, Europe included, looking to the United States for both food and manufactured goods. Hence, there is no longer a triangular balance. Foreign countries as a whole want more goods from us than we want from them. This leads to a dollar shortage. If people want more goods from us than they can earn dollars by sales to us, then, of course, there is a shortage of dollars.

If there is a dollar shortage, why not trade in other currencies? Currency is useful only in terms of the things it will buy. This is hardly a new or startling fact to you, but if you will bear it in mind, it will help you to see what I'm driving at. 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 is such a tremendous quantity of goods and services produced in this country on which they can spend those dollars. If they don't want to buy anything from us, they can use the dollars to pay for goods purchased from some other country, because that country will generally find something it wants to buy in the United States.

Britain, on the other hand, does not have such a great 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 foreigners are to accept that currency. A lot of countries acquired sterling balances during the war for which they would like to get some goods. England cannot exchange its currency for other currencies, because it is not earning enough of their currencies by sales to them. It is therefore compelled to make the pound inconvertible--hence that much less desirable.

The solution to currency difficulties, and balance of payments difficulties as well, is to find some way of selling more of your goods to foreign countries, or to reduce your purchases 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 that can be done to sell more goods abroad? If other countries won't remove their restrictions, the only alternative is to cut prices.

There are two ways to cut prices--one is by internal deflation; the other is by depreciation of your currency with respect to other currencies. Deflation is a painful remedy, because it has the effect of depressing economic activity within the country. Depreciation also has its drawbacks, but they are not so severe.

Let us look at what England actually did. When the war ended, the pound-dollar exchange rate was $4.03, 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 the level of prices in both countries. After the war, there was more inflation in Britain than in the United States. Buyers could no longer get a satisfactory exchange of English goods for American goods at the then pound-dollar radio. The British, of course, could get great bargains in our goods, except that they couldn't sell us enough of their goods to raise the cash to buy from us. They were compelled to adopt a new pound-dollar ratio of $2.80. Now remember, this does not change the price for local goods in England. It does, however, enable Americans to get more English goods in return for American goods. It also means that the English have to pay more in pounds for their purchases of food and raw

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materials from the dollar area. This has the effect of partially nullifying the benefits of depreciation because an increase in the amount of sterling paid for imported materials must be reflected in the sterling price of manufactured output. Nevertheless, the depreciation did improve England's position in the world market. If she were as self-sufficient as we are, the move would have been far more effective.

Let us turn now to the matter of United States foreign economic policy. Economic policy is closely interlocked with political policy. Unless a nation's policies in the two fields are consistent, it is highly unlikely that they can be made to succeed.

Our attitudes toward the rest of the world have changed tremendously since the 19th century. The changes which have taken place in our political and economic situations compelled a reorientation of our economic policy. Distances have contracted so that we are no longer able to divorce ourselves from what happens in the rest of the world. It has become necessary for us to get a lot of things from the outside to maintain and improve our standard of living. We have come to believe that our national security requires us to have friends. Those friends cannot make contributions to mutual security unless their economies are healthy. We must, therefore, adjust our own economic behavior so as to contribute to the health of our friends.

Our recent Administrations have seen the need for a policy of freer trade. Ever since 1934, when Congress passed the Reciprocal Trade Act, we have been moving in this direction. President Eisenhower, in his State of the Union message said: "Our foreign policy will recognize the importance of profitable and equitable world trade." One of his recommendations was for the removal of the procedural obstacles to trade from our customs regulations.

But, as so often occurs, in policy matters, the Executive Branch of the Government may see very clearly the proper policy approach and yet be prevented from carrying it out in a consistent manner by political pressures. Industries which feel themselves unable to compete in the open market with foreign products will continue to exert pressures to prevent the lowering of tariffs on the products they make. The President recognized the political facts of life when he qualified his recommendation on the removal of customs obstacles by saying: "This objective must not ignore legitimate safeguarding of domestic industries, agriculture and labor standards."

You are all familiar to some degree with the steps which this country has taken to restore the economies shattered by the war. We gave away a lot of money in the last seven years. The decision to do this was relatively easy. It was a rescue operation of the sort to which Americans respond very generously. We are faced with a stiffer problem now. Most of the countries involved have achieved--and surpassed--their prewar production levels. We see no further need for charity and the other countries themselves recognize the corrupting influence of further aid. We have been hearing the slogan "Trade not aid" in recent months. It is obviously to our own best interests, and to those of other countries as well, for them to be able to pay their own way. The difficulty arises when we try to determine what we should do to give them a fair chance to succeed. Throwing open the American market to their products would help, but I have already mentioned the political difficulties. Even if there were no United States customs duties, the industrial countries of Western Europe could not close their dollar gap by this means alone. The question of what else must be done is a very tough one indeed.

Now let us see why international economic relations are important to economic potential and economic potential for war. First, we have seen from our analysis of absolute and comparative advantage that, if each country undertakes to produce those items in which it is most efficient, we get the most effective use of our economic resources. This is just another way of saying that we get maximum utilization of our economic potential. Second, international trade is the only way to get some of the things we need for our economic potential for war. Third, if we conduct our international relations so as to keep our friends strong, we improve the ability of the Free World to support a war. Then again, by developing the backward areas of the world, we make available greater supplies of raw materials needed by our economy in general and our war-production machine in particular.

True, there is one drawback to increasing economic potential for war by the development of foreign sources of materials and manufactures. There is a risk of being cut off from these sources when war occurs.

Actually, this risk ought not to be regarded as something peculiar to international trade. The same considerations govern when we make decisions concerning the location of industries within our own national boundaries.

We are beginning to look at the problem in a somewhat less nationalistic light. With the advent of NATO and other international arrangements for defense, we have become aware of the possibilities for a more efficient division of labor. The first concrete step in that direction is the off-shore procurement program. As the chances improve for preserving the integrity of the entire NATO area against enemy attack, we should be willing to plan our production of goods and services for war in such a way as to let the Europeans do those things which they can do most efficiently.

Now to summarize. My main point is that international economic relations are good for everybody. From the economic standpoint alone the notion of international trade as something different from domestic trade is completely artificial. There ought to be no difference between buying something made in Illinois and something made in Italy. It is only the political restrictions imposed by national governments that prevent this from happening. When the day comes that you and I can make our choice between buying cheese from Wisconsin or cheese from Denmark solely on the basis of who makes the best cheese at the best price, we will all be better off.

QUESTION: I would like to bring up one point which you haven't mentioned and which I think would force the greatest pressure of all so far as international trade policies are concerned. That is the question of labor. I think our present national labor policy is that we will never duplicate what happened in the 1930's, the national unemployment. Now, free trade, as you indicated at the end of your talk about buying cheese from Denmark, and so on, would be perfectly all right if we all lived on the same standard of living across the world. But if Germany with cheaper labor can undersell us on electric appliances, the British on textiles, and France in particular items, despite mass production because of high labor costs here, we are likely to get unemployment and we would get a tremendous amount of pressure from labor groups to restore our tariffs. Would you care to comment on that?

COLONEL WATERMAN: Yes. This is what is known as the "cheap foreign labor argument." In the first place, generally speaking, the notion of cheap foreign labor is completely erroneous. In those things which we do efficiently our labor is far cheaper because it doesn't matter what a man gets per hour. What matters is what does he get per unit of product. In the industries in which we are efficient, our labor is far cheaper than foreign labor. In fact, the Japanese groan over the competition of "cheap American labor."

We have no vested interest in any standard of living. I think in general we have to do what we can to preserve full employment. Full employment versus foreign trade is a complicated question. But we are entitled to the standard of living we have just so long as we earn it by being productive. I don't see that we have any claim to a higher standard of living than anyone else in another country merely because that is what we would like to have. I think that it is necessary that we earn it. I don't believe we have a vested interest in it.

You could apply the same thing to the Northeast and Southeast in this country. Why not have a trade barrier there? They have cheaper labor in the South and they undersell the industries in the north. Because labor is cheaper within a region, I don't believe there is a vested interest in a different standard of living. I realize there are lots of complications about the domestic effects of unemployment, and it is a fair question, one that a lot of people spend a great deal of time on. But simplified, I think that is a fair response to the point you make.

QUESTION: I guess it is because I am a rather naive person and not an economist, but when I buy something I have to pay for it. If I run out of money and have to borrow money somewhere, I have to put up some kind of collateral. I wonder how it is that no one has ever given some thought or why they haven't published something on it, of our taking a little collateral on some of this money we give away in the form of raw materials--somebody's colonies, say a lease for a hundred years to England's Gold Coast. If they happen to have something we need, go in, free from their horrible taxation system, free from fear of expropriation.

COLONEL WATERMAN: There are political implications involved in that. The people themselves in those places would object to being taken over.

QUESTION: You are assuming there are natives within these places that would resent being taken over. But if you take a place that has raw materials which these people are not developing because they don't have the facilities; they have no money; they have to buy machinery from us to develop it. They can't do it standing alone. Those same natives would gain more, it would relieve them of their current burdens and give them far more for the money. I think that is the type of thing involved there rather than taking people's freedom away from them.

COLONEL WARERMAN: You are absolutely right. We are carrying on economic development programs now. They are going slowly because people are funny--they want to do things the way they want to do them. They don't like to be told how to do them. As we say, "People shouldn't be like that." Those are political realities which you have to recognize. You can't operate in the economic field alone.

QUESTION: It looks like in the United States a lot of these things are political. Not only that but some of them are bilaterally political, such as the value of the pound versus the dollar. Is there any ray of hope that there is going to be some political action to improve that situation?

COLONEL WATERMAN: I think there is. It is essentially the influence of the political structure that causes things to be what they are today in the economic field. We might have had the same difficulties in our own country had we not stopped at its inception in 1776, the attempt of states to erect tariff barriers.

The reason I say that I think there is a ray of hope is that we have before us the European Steel and Coal Community, the Schuman Plan. That is a supranational activity. It means that six nations in Europe are agreeing to eliminate present tariff barriers on coal, iron ore, and steel, and the governing body for the European coal and steel community there will be supranational. That is a kind of step toward a union, and it is probable that economic effort implied by the Schuman Plan can never be successful until some political union has been effected. If there is one economic system, there must be one political system. There has been so much talk of economic union and political union in Western Europe that I think it is very hopeful that it might be one solution to the problems of Europe, because if tariff barriers come down, it will give them markets sufficient to use the techniques of mass production. If they can do that, they will have hope.

QUESTION: Depreciation of currency seems to be a slick trick for getting around tariff barriers. What would happen if, when currency is depreciated by one country, other countries raised their tariffs a proportionate amount. What would be gained by depreciation?

COLONEL WATERMAN: Nothing. As a matter of fact, they don't do that but they do have competitive depreciation. That happens a lot. Remember that the value of a given currency on the world market is maintained somewhat by artificial means, usually by the country in question being prepared to buy and sell its own currency at certain rates that stabilize the currency. Suppose there were no such artificial means of pegging currencies, what would happen? Currencies would be just like commodities. What they would sell for would depend on supply and demand. This would make a lot of confusion in world markets. But it might perhaps be a sensible way of fixing the value of currency because if you wanted currency to buy something, how much you would pay for it would depend on how much you wanted that article and what price you wanted to pay. All the while there would be a balancing off of currency, and exchange rates would fix themselves, depending on the desirability of the products of each country.

QUESTION: I would just like to bring up the point that it seems to be the opinion of Great Britain and France, anybody we can help benefits. In this country it is the Department of Defense and the three services. Has anybody ever made an analysis of how much of the cost of our foreign aid is due to the fact that we have an iron curtain, an arbitrary blocking of certain national patterns of international trade. Maybe we are throwing rocks at the wrong people. Maybe Soviet Russia is causing a lot of our headaches.

COLONEL WATERMAN: There is a lot in what you say. Tom O'Neil will be discussing that next week in "Economic Warfare" so I won't go into that here.

QUESTION: Last fall we had one of the lecturers make a very thoughtful statement to the effect that tariff barriers, whether they are against the general interest or not, all work in favor of many individual interests throughout the country. Now if that is so, why wouldn't it pay us to assume the costs to these people who are going to be injured by a reduction in tariffs, either buy them out or otherwise. If you build a highway through a man's property, you have to pay for the land. If you put a man's business out of commission that he has built up under good faith, under one set of political rules, and you change them, why wouldn't it be good business for us to assume the damages to him?

COLONEL WATERMAN: It is good business. That is the sort of thing people like Henry Ford are proposing--let us help people who have been put out of business so they can get reestablished. Perhaps we can help them make a new product which can be made more efficiently, or readjust their labor so that everybody finds a job. It wouldn't be hard actually. If you let somebody else outside produce and sell more, he is going to buy more things. That means more demand for the things we make. So there would be readjustments that would leave everybody better off. Most of the proposals for eliminating tariffs do come out with the suggestion that we subsidize the readjustment of the people who are injured. I think it is a fine thing to do.

QUESTION: Pursuing that a bit further, suppose we did get that step accomplished and then take the next obvious one, you come to a world currency; whether it is a unilar or something else doesn't matter, you still have what you call the dollar gap or dollar shortage. Whatever you would call it, wouldn't it be just like the coal miners when they price themselves out of the world market?

COLONEL WATERMAN: The answer to the question is this: You could call this currency a unilar or an epunit as they do in the European Payments Union but remember this: A currency is just as good as the Government behind it, and, by the same token, the production behind it. The United States dollar, the British dollar, the French dollar, call them all the same thing. Remember this: that dollar will be desired in the world market to the extent that the Government behind it is good and the production is behind it. So even if you attempted to make a world currency, you would still wind up with the units of currency divided, depending on who put them out. So you can get a single currency only when you have a single government.

COMMENT: I have a different answer. You might compare Italy to the United States. Suppose the whole world was on the United States dollar and Italy was using the United States dollar. It would mean that if Italy didn't have the production behind the dollar, it would become a depressed area as the South might be called in relation to the North.

QUESTION: Could you explain how bilateralism conflicts with the most favored nation clause?

COLONEL WATERMAN: The most favored nation clause is a device by which you get multilateralism rather than bilateralism. "Most favored nation" in its usual meaning means that you agree with all of your trading partners that if you give anybody else a better deal tariff-wise, let us say, or commodity-wise in a future agreement than you are giving your present trading partners, you will extend those terms to the present trading partners.

Let us say, for example, you have an agreement in existence with European countries and you find it favorable to make a new agreement with France. All right. You make that new agreement with France and give her better terms for the exchange of goods by lowering tariff barriers. If you have previously made a most favored nation trade agreement, then when you make this new agreement with France, you automatically apply the terms of the new agreement to the other partners with whom you had the most favored nation trade agreements.

QUESTION: It really means you don't have any most favored nation?

COLONEL WATERMAN: That's right. It is in a sense a negative proposition.

QUESTION: When the relationship of the pound to the dollar went from $4.03 to $2.80, why didn't the price of Scotch go down even a little bit?

COLONEL WATERMAN: That is more in Dr. Kress's line. Andy is a price man. He believes very firmly in the law of supply and demand. The law of supply and demand is still in force in some places. If you want Scotch bad enough you pay the higher price for it.

DR. KRESS: That is one of the areas that is supersecret. Actually the British Government handled those deals and pocketed the difference. That is what happened.

COLONEL WATERMAN: Fundamentally, of course, it simply means that the traffic would bear it. They were able to raise the price of Scotch because they could sell at the higher price. If they hadn't been able to, they wouldn't have raised the price.

Thank you very much.

TABLE I. 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

CHART II. COMPARATIVE ADVANTAGE

	Machinery			
	Production cost (dollars)	Selling price (dollars)	Unit prod. cost (dollars)	Machinery equivalent
ENGLAND	75	108	5	15 (units)
CHINA	115		6	18 (units)

CHART III

HINDRANCES TO INTERNATIONAL TRADE

TARIFFS

CUSTOMS PROCEDURES

QUANTITATIVE RESTRICTIONS

- QUOTAS
- EMBARGOES

NATIONALISTIC RESTRICTIONS

- "BUY AMERICAN"

SUBSIDIES

BILATERALISM

EXCHANGE RESTRICTIONS

- INCONVERTIBILITY
- MULTIPLE RATES

CHART IV

UNITED STATES BALANCE OF PAYMENTS

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 and investments to U.S.	100	
Gold received		100
Gifts and grants		
Private		100
Government		1,000
	1,500	1,500

(not actual figures)