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POSTWAR ECONOMIC RECOVERY AND TREND TOWARD ECONOMIC INTEGRATION OF EUROPE

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COLONEL WATERMAN: This is the second part of our two-part program designed to give you a broad general picture of the economies of western Europe. Yesterday we had a chance to acquire some of the information about the recent historical background of these economies. Today we turn to the current situation.

Our speaker is Mr. Harlan Cleveland, the Executive Editor of "The Reporter" magazine. Mr. Cleveland is going to talk to us on the subject, "Postwar Economic Recovery and Trend Toward Economic Integration of Europe." He is in a particularly good position to deal with this subject because he has just completed almost two years as assistant director for Europe in the Mutual Security Agency (MSA).

The economic problems of western Europe have been matters of daily intimate concern to him, and it is certain that he is in a very fine position to give us up-to-date information.

We are most happy to welcome Mr. Cleveland to the Industrial College.

MR. CLEVELAND: Gentlemen: What I would like to do this morning, for what I hope will be the requisite time, is to talk first about Europe in its relationship to the rest of the world and, second, about the relationship between economics and rearmament within Europe itself. I put these two points in this order because the basic limitation on what Europe can do about rearmament and about raising the standard of living of its own people, is its competitive position of trading in the world; and the simple fact is that Europe's resources and institutions are not up to the job of doing the two main things that the Europeans would like to see done--defending western Europe against possible aggression from the East on the one hand and bringing about a continuous rise in consumption by their own citizens on the other hand.

We hear a lot these days--a good deal too much for my own taste--about this phrase of Rab Butler's, "trade, not aid." The trouble with the phrase is this: It is only a very narrow concept of the problem that faces England or the whole of western Europe. My own formulation would probably substitute the words "economic growth," for the word "trade" in that little slogan, because the fundamental trouble, it seems to me, with western Europe, is the lack of an adequate rate of economic growth.

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Now, first, on the question of Europe's relationship to the rest of the world, it is important to remember, I think, some fundamental facts, not one of which is a bit surprising to any literate group of people in this country any more; but, all of which have to be put together to get a sense of what really are the basic trends in this period from, roughly, the halfway mark of the twentieth century on into the future. Let me just check off these big twentieth century facts very briefly.

The first fact, and the most familiar and almost banal fact of all, is that the world is small and getting smaller. We hear this so much, and repeat it so often ourselves, that we are inclined to forget what a staggering fact it is. We are inclined to forget that the contraction in the size of the world as a whole, which is happening for scientific and technical reasons, has a great many political and economic ramifications that the political and social sciences have not really caught up with as yet.

The second big fact is the size and rate of growth of the Soviet Union. This is of course one of the main things that you are studying, I take it, in this course, the relationship between the free world and the Soviet Union and their respective rates of growth. Over a long period of time, given the present rate of the Soviet Union's annual economic growth, coexistence with the Soviet Union would be a very disastrous policy unless we greatly step up the rate of growth on our side of the Iron Curtain.

I am sure you are getting all kinds of estimates on the subject of the Soviet Union rate of growth of total output, and the Lord knows whose figures are right. I have seen figures that range from 8 to 11 percent a year. This is a rate of growth, if it is anywhere in that general neighborhood, that is equaled in the free world, curiously enough, by only one country, and that is Turkey. Turkey has grown rapidly in recent years for reasons similar to those which cause the Russians to achieve their striking rate of economic growth; namely, a tremendous concentration on building up agriculture and a concurrent program of industrialization. The Turks have been helped by good weather, too. We don't get anywhere near that 10-percent-a-year rate of growth and neither do the Europeans.

Now, so far as the Soviet Union is concerned, and its satellites, this rate of growth in itself obviously would not be a problem. The thing that makes it a problem is of course that you have to multiply capabilities by intentions in order to get something that is meaningful for security planning. It is the intention of this dynamic force, it is the fact that it is aggressive as well as economically dynamic, that makes it dangerous.

I stress the position of the Soviet Union because, whenever you are talking about the economic problem of Europe and the United States and the rest of the free world, one of the biggest elements in our calculations has to be the claim on the total product that is represented by what is necessary to meet that dynamic and aggressive threat from the other side. So let us keep the Soviet threat in mind as big fact number two.

Big fact number three is again a familiar one--the strength of the United States. It still stretches my imagination to repeat the proportion that our output bears to the output of the whole world. Here we are with 7 percent of the world's population producing something like 40 or 41 percent of everything that gets turned out in a year in the entire world. This is, say, 40 or 41 percent of what you might call the world's gross national product. It is this economic power, this potential, if you will, from which flows the leadership that we have had to assume in the world.

Now, what I want mainly to talk about this morning are the fourth and fifth big facts about our twentieth-century world that set the conditions of western Europe's rearmament and prosperity. These facts are, fourth, the weakness of Europe and, fifth, the extraordinary changes that have taken place in the character of economic policy and of economic relationships in the underdeveloped areas of the world--properly speaking, in Asia, Africa, and Latin America.

Let me talk first about fact number five and then come back to Europe. I think we have to see the underdeveloped areas as having gone through something more than the kind of standard newspaper parlance--"political revolution," or independence movement. What we have to see is that there is an economic as well as a political side to this drive for independence.

A country like Indonesia wants to get independent of colonial ties on the political side, but this drive for independence has also greatly affected the economic thinking of the leaders in Indonesia and in just about every other newly independent or emerging semi-independent country. Whenever one of these independence movements' nationalist groups comes into power, the new leaders have rather fixed theories about what it is that they are supposed to do with the economy. They are perfectly clear that dependence on sizable exports of raw materials to the industrialized areas of the world dependence on digging and growing materials that will be sold to Europe and the United States, dependence on a world market that has a tremendous tendency to fluctuate up and down, is really not good for them. This negative drive to get away from dependence on raw material exports is usually combined with a tremendous, almost fanatical, belief that industrialization is the way to independence of colonial mastery, is the way to a great, immediate, dramatic rise in the standard of living of their people.

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Now, we can hardly blame them for having these views. After all, what they are looking at is the example of the United States, the example of Japan, the example of the Soviet Union. So that very view, that rapid industrialization is the road to success has a good deal of historical precedent behind it. But the trouble with these views is that in the modern world the most difficult prospective shortages in the world are those of raw materials rather than of finished products--a situation wholly different from the situation 100 years ago. Consequently this policy doesn't make nearly as much sense for them as it did for us 100 years ago or as it did even in Japan 50 years ago.

These emerging nationalists have another rather natural idea--that great changes like industrialization can be accomplished almost overnight. This is an idea they get from us again, that they pick up from our tendency to try to do a lot of things at the same time and rapidly. It is no doubt one of the products of our technical assistance abroad. They drive ahead toward these goals of getting away from dependence on raw materials and on to rapid industrialization. Some of them of course really come a cropper. Argentina is the best example at the moment, a country that is associated, I am sure, in all your minds with wheat and meat, having meatless days and importing wheat, at the same time as it is unable to sell some of the textiles and other finished products that are turned out by its newly industrialized economy.

Rapid efforts in this direction also produced in the underdeveloped areas a tremendous overuse of the resources available, which is just another way of saying inflation. So you get the government trying to do just too many things at once, and you get the sort of phenomenon you got in Australia, until they got hold of it six months or so ago. In Australia a program of rapid industrial development attracted people off the farms and into the cities by very high wages; but then it turned out they didn't have the food and wool, and so forth, to produce to sell abroad to get the foreign exchange they needed to continue with their industrial development program. So they had to call a halt and start over. You get a similar phenomenon in a number of different countries, of which the Argentine and Australian cases, being quite extreme, are the best current examples.

Let us move to Europe for a minute and look at the rest of the world through Europe's eyes, and see what effects these basic trends have had on the position of the Europeans. These trends have not been operating only in the postwar period; they are broad, deep, secular trends that have been with us for close to a half century.

The two main symptoms of Europe's weakness are: (1) the declining relative rate of growth of productivity, declining relative to the United States, which sets the standard in these matters these days; and (2) the changed competitive position of western Europe in relation to the underdeveloped areas. The changed competitive situation is obvious from what I have said about the change in the underdeveloped areas themselves.

Europe, after all, is an industrial workshop. It takes in raw materials and it sends back finished products. Close to 90 percent of all its imports are raw materials and rather more than 90 percent of its exports have gone through some processing stage in Europe. So you have to think of Europe really as a great machine shop which has to find a way to feed its workers, which has to find a way to clothe them, to get the primary materials for them to work on with their machines, and, to some extent even to get the know-how and most modern developments of machinery from a better equipped, more modern, high productivity machine shop across the street. And this somewhat tired, elderly machine shop is in a position where the people who make all these raw materials, who grow the food and chop down the trees, and who take the tin out of the mines and who put the little cuts on the rubber trees, are all trying to get away from doing that kind of thing so that they can get into making textiles and small bicycles, and one thing and another.

So that the suppliers are in the process of getting away from raw material production and this is having the effect of constantly raising now the price of what Europe has to buy from abroad relative to the prices Europe gets for the products it sends in return. I don't know whether Sir Roger Makins, when he was talking to you about Britain, gave you what has always seemed to be the most striking example of this fact. Since the war Britain has put on a tremendous export drive. Britain is now exporting something like 70 percent more to the rest of the world, by volume, than Britain was exporting before the war, while the British are now importing about the same amount by volume that they did before the war. And yet, they are not quite making ends meet even so, whereas before the war they were by and large staying even on their balance of payments.

So here's a machine shop, if you will, which has sent abroad 70 percent more than it did before the war and is getting back the same amount that it did before the war; but is in a worse hole financially than it was before the war. It is an extraordinary fact. We are inclined to believe that, well, the Europeans aren't trying hard, and they are not really getting on with their export drive, and so forth; but here's a really impressive export drive in the United Kingdom, and all its people have been able to accomplish with it is to buy with 170 percent of what they were doing before the war, an amount of raw materials and food equivalent to what they were getting for 100 percent before. So that the entire postwar export drive of Britain has been wiped out by this change in what economists call the terms of trade, by this change in the trading relationship between Europe and the underdeveloped areas.

On top of that, the kinds of things that Europe sends to the rest of the world are in some cases precisely the kinds of things that these nationalists in the underdeveloped areas are especially anxious to produce for themselves--textiles, for example. Why is there trouble with unemployment in Lancashire? For the perfectly obvious reason that all over the world the nationalists who are achieving their political independence and learning rather soon that the steel plant they have had their eyes on all along as the symbol of their industrialization program, is out of their reach, have turned to producing textiles as the opening wedge of their industrialization drive.

This has been going on to some extent for several decades, certainly, but it has actually been stepped up recently. Textile production is a big part of Peron's industrialization program, for example. So the total market for export textiles has gone down. The total amount of textiles before the First World War that was exported by all countries--you just add up everybody's exports and it amounts to just about twice the total amount of everybody's textile exports today. This is not because people are using less textiles; it is because there is more "domestic" production, more use of their own goods by nations that used to import textiles.

On top of these two trends--the terms of trade and the competition with Europe's traditional exports--you have this other factor of a low rate of growth of productivity in Europe. To continue the textile example--Britain, who used to have three-fourths of that big textile export market, something like 10 billion square yards of textiles, now has only about a quarter of the total export market for textiles. That is not much more than 5 billion square yards. Europe has not only lost the possibility of producing textiles and selling them to other people as a business it can depend on, but it has even lost dramatically in the share of the smaller market that now exists.

This loss in the share of the market is not primarily a question of the terms of trade; it is primarily a demonstration that Europe is falling behind in its relative rate of growth.

I have mentioned the Soviet Union. Over the last 40 years or so we in the United States averaged year in and year out about an annual 3-percent rate of growth productivity. When I use the term "rate of growth" what I am talking about is the increase in the gross national product per employed worker, which is, therefore, as close as you can get to a measure of productivity, of output per man-hour. It is the ability of the economy as a whole to produce more and more with the same number of people.

Now, we grow at least 3 percent a year. Bear in mind that these figures, the Soviet 8 to 11 percent, and our 3 percent, are compound interest. Starting at any one moment, you add the 3 percent and then the next year you are taking 3 percent of 103, and so forth. So, especially when you get up to something like 8 percent a year, you can make very dramatic changes over a period of 10 or 20 years in the absolute amount of production, the absolute amount of output. Don't be fooled by the relatively small-sounding figures of these percentage increases. From year to year over a long period they mean a lot, as we have seen in our own economy and our own standard of living.

In Europe the rate of growth on a comparable basis for the major countries has been running at 2 percent or less over the last few decades. During the period of the Marshall Plan there was a spurt in the yearly rate of growth up to 5, 6, or 7 percent in some of the countries. The Germans, even last year, increased their total production per employed worker up to something like 7 to 8 percent. But this was a pretty temporary phenomenon. It was the result of putting to work resources that were unemployed or underemployed as a result of the war--people who were out of work, facilities that were destroyed, markets that had not yet been established, and so forth.

Soon they came back to something like full employment, not only of people but of facilities, in the major countries of Europe--in France, in England; even in Germany, where they have absorbed 10 million refugees and still they have something remarkably close to full employment.

The total rate of increase now is falling off very sharply in the last year. So don't look at the Marshall Plan figures--in spite of the fact that I was heavily involved in selling those to the Congress and to the country as an indication of the greatest success ever perpetrated by the U. S. Government--don't look at those as the standard of the long-term performance by Europe. In England during this last year--and this Sir Roger probably didn't tell you at all--the gross national product really has hardly increased at all.

This is the sum of the basic factors limiting productivity coming into play. What are those basic factors? It seems to me they can be summarized in two main categories, neither of which is, strictly speaking, an economic limitation; but both might be described as institutional limitations. One of these limitations is sheer size. For better or worse, and whether we like it or not, the size of a modern industrial economy, the standard of size for a modern industrial economy, with the amount of mass production that is required for a rate of growth of productivity even as great as our own--that standard of size is set by the United States, and to some extent, also, by the Soviet Union.

The big economy is the big, stable, dependable home market. It is an essential ingredient in rapid growth. Now you are familiar with the story of the cut-up European economy. One of the main things that Paul Hoffman talked about during the shole period he was in the Economic Cooperation Administration (ECA), one of the main things that was pushed all through the ECA and MSA program, was economic integration. This wasn't because this was regarded as ideologically good or even primarily because it was a political or military necessity, which I believe it to be; but because there are good, solid, economic reasons why the Europeans--if they are going to depend on industrial production as the basis of their growth and on selling a considerable part of the result of that industrial production abroad in competition with us--are going to have to find a way of establishing a bigger home market.

The obvious way to do that is the way we have been talking about for years, by an actual combination of national economies in such a way that there are no customs and tariff and quantitative trade restrictions on the movement of goods within that total market.

Secondly, the reason for this weakness of Europe, this low rate of growth of productivity, is the restrictive mentality and business attitudes of Europeans generally. This is not just a question of a few European businessmen being monopoly-minded and cartel-minded. Business, labor, agriculture, and government in Italy, France, Germany, England and the other countries, to a greater or less extent, are monopoly-and cartel-minded. This is something on which you can get complete agreement between a left-wing socialist in Italy and the most extreme right wing of the Italian Federation of Industrialists: that the worst thing that could possibly happen in Italy would be a lot of competition, would be a loosening up of credit so that small businessmen could get into a new business and not automatically go broke.

This is a problem which we wrestled with some during the Marshall Plan, but to which I think it is fair to say we haven't even begun to find the answer. But until there is some answer to it, you are not going to get in Europe a rate of growth of productivity that is comparable to ours; and unless it is comparable to ours, the Europeans' competitive position in the world is going to be constantly worsening. And this is not something that is static; it is something that gets better or worse. Where our productivity is increasing at a 3-percent rate and theirs at a 1 or 2-percent rate, the curves go off like that (indicating) and the gap gets bigger and bigger.

So a solution to this problem of restrictive practices, which is not going to be our kind of solution with antitrust legislation, leads you back to the concept of the single market. All of the institutional arrangements that have hardened the arteries of the European economy have been set up and blessed by the actions of individual national governments. The process of trying to persuade those individual national governments and the interests on which they depend to abandon the way they do things and to do things the way we do them is really hopeless. But the setting up of a new authority for economic coordination that is above the national level, and the automatic abandonment of some of the existing arrangements that are based on control of the national legislature may, and only may, blow some real winds of competition into the picture; because, for particular groups, such as the German steel producers, the Italian electrical people, and so forth, there will be advantages for them in competition.

So the first step is going to have to be some kind of new framework of doing business, a framework in which most of your business is done inside a home market, rather than where most of your business is done across national boundaries where the controls of governments are really the main thing you are worrying about, rather than the supply of and demand for your product.

Now, this is the broad picture on why Europe is weak and noncompetitive in the rest of the world; there are restrictive practices, small economies, and then, on top of these basic trends there are certain special factors resulting from the war itself. Emphasizing that these special factors are not the main point, in my estimation, they still had an important effect in sweeping away some of the cushions on which the European economy had been lying during the interwar period, and in demonstrating to the Europeans that they were really in great economic difficulties.

The main things that happened during the war were these: First, the straight war damage. I think that problem could be said to have been pretty well solved by the application of assistance through the Marshall Plan and so forth. Second, the loss by Europe of some of its lucrative colonies and a great many of its lucrative investments. The British, for example, went from a situation where the world owed them a living and they were clipping coupons on nineteenth century investments as a way of covering the deficit in their balance of payments with the rest of the world, to a situation where they owed the rest of the world--mostly their own dominions, but also other countries--something like 10 billion dollars. They not only have the problem of trying to re-establish their competitive position which has been worsened by adverse factors and war damage and to settle themselves in the world--they have also the problem of paying back war debts on which they get no current return in the form of raw material or food imports.

This European problem, I think, can be tackled adequately by us, and with the strength that we can add to the situation, only if we come to recognize that this is not a problem that started with the last war and it is not a problem that is going to be discontinued at the end of the Marshall Plan, at the end of the present Mutual Security Act, or at the end of any other date that the mind can think up. Looking back on

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it, it is hard to say what else we could have done in 1947 than to predict complete success by the end of four years or some other date. After all, getting a four-year plan adopted, even with annual appropriations, was a great improvement over the six month programs that immediately preceded it. It gave more of a chance to plan and tackle the basic problems.

But the fact is, the problem is not four years long, it is from 40 to 400 years long. This technique of going to the Congress each year and selling them what you might call isolationist futures--that is, "we can't be isolationists this year, but in three years we can go back to being isolationists"--is not a useful public policy any more. It is only when we begin to recognize how long the problem has really been with us, which we didn't adequately recognize in the heat of the postwar rehabilitation plan, and how long this problem is going to be with us, given the disparity in the rate of growth of productivity and the changes in the underdeveloped areas, about which I have spoken, which are not going to be reversed in the second half of the twentieth century but will continue and be intensified, if anything--it is only when we realize that the problem is, to all intents and purposes, permanent that the kinds of policies we work out to deal with it will make an amount of sense that is commensurate with the difficulty of the problem itself.

Thank you.

COLONEL WATERMAN: Mr. Cleveland is ready for your questions, gentlemen.

QUESTION: Granting your point that part of the economic trouble of western Europe is due to the industrialization of the underdeveloped areas, how do we rationalize our ECA on the one hand, or the defense support on the one hand, and Point IV on the other hand?

MR. CLEVELAND: Well, first of all, the primary emphasis of the Point IV kind of program, both that part of it administered by the Technical Cooperation Administration in the State Department and that part in the Far East administered by MSA, isn't in building up sizable industries. The primary emphasis is in local production, in agricultural production, which goes in the right direction because it increases the amount of primary materials in the world; and the thing we have to watch in the second half of the twentieth century is not to contract the amount of raw materials and food in the world in our drive for industrialization.

I don't think there has been full clarity on this point in the United States policy. I think we have tended in the United States, in the U. S. Government, to believe that anything that the nationalists thought was good for them they should have. My own formulation on that would be this:

We ought to be in favor of whatever kinds of economic policies we think will really be good for the nationalists. After all, for a newly independent government in an underdeveloped area to set off on the road that has brought Argentina to the brink of economic ruin would be ridiculous, and it is even more ridiculous for us to help them move along that road; so I think that there is a clarification needed in our own policy.

I think generally, in the Point IV kind of program the tendency has been to help these emerging nationalisms with whatever kinds of economic programs seemed a good idea at the time. I think that was probably all right as a starter, but it is not all right as a long-term policy, because, as a long-term policy we have to think in terms of the sort of pattern of production and trade in the free world as a whole which will make the free world as a whole stronger.

I think the same thing applies in Europe, Colonel, and I know you are very familiar with it. Now that I am out of the Government, I can be wholly objective about what I was doing. I think that in the Marshall Plan, by and large, starting in 1948, we tended to say to ourselves that any production increase is about as good as any other production increase. So we looked at long lists of statistics on how production was going up. After all, steel production was going up in France; textile production was going up in Britain--or the British were producing jets and textiles, some of both. This was regarded as a fine thing.

As a matter of fact, the best thing England could have done would have been not to increase the production of textiles at all, but at the level of production where they were or even at a lower production, to modernize and get more efficiency; not to increase the total production of textiles, but to put even more effort into jet engines, for example, in which they are far and away ahead of anybody else in the world--they're far ahead of us.

So this rethinking of the direction of what you might call the pattern of production that we are trying to move toward in the rest of the free world as we give out aid, technical assistance, and so forth, has to be reaffirmed in the underdeveloped areas and Europe. The two will make sense. I think that's the point you are getting at.

QUESTION: The over-all impression that I obtained from your presentation is that the solution lies more nearly in the underdeveloped countries developing their basic resources, their mineral and agricultural products, and letting the manufacturing and industrialization remain in Europe. You also indicated that the price controls and the demands are controlled by the industrial areas. As a consequence, you would have the underdeveloped countries in effect remaining colonies of Europe.

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That would seem to be contrary to the nationalism and independence and all those desires of those particular countries. How can you reconcile the nationalism and the independence with our Government approves as a matter of policy with what you say is the over-all economic solution?

MR. CLEVELAND: We should, in my opinion, promote the growth of primary production, particularly in the free world. But the fact that we adopt that attitude doesn't mean the industrial countries ought to continue to set the prices for the primary products pretty much at their own free will.

Take the situation inside the United States. Now, one of the things that farmers have always been concerned about in this country, at least up to the beginning of the concept of parity, was that the prices for the things they had to buy were always set by people other than themselves; but so were the prices of the things they had to sell. The urban market set both prices; and the terms to the individual farmer, how much he could get for the individual bushel of wheat he was selling, was something he had no control over. What did he do? He had recourse to political action which resulted in the parity concept, and we have a situation now where farmers have much more control over the prices of what they produce.

Now, I think you have a similar trend for the future in the free world taken as a whole. There is now a lot of talk about raw materials, price stabilization, and international commodity agreements, and so forth, as the result of this feeling on the part of the underdeveloped areas that they don't control enough. I think myself as part of the process of persuading them to stay in primary production we ought to make a concession on the price by having them participate in the marketing and pricing arrangements for their own products. It seems to me that is the pattern of synthesis on that apparent contradiction.

QUESTION: Some of us understand that Europe as a whole is a fairly balanced economic unit, with eastern Europe contributing agricultural products and raw materials, and western Europe the workshop of which you spoke. We have further been told at the beginning of the Marshall Plan program that trade between western Europe and eastern Europe should be encouraged in order to help western Europe. I wonder if you would comment on the effect of the trade barriers, or the Iron Curtain, so-called, between eastern and western Europe; how much trade is going on and whether, in your opinion, it should be encouraged in order to help western Europe in its problem.

MR. CLEVELAND: That is quite a large question. First of all, I think there's a tendency to overstate the significance of eastern Europe, both as a market for Europe's industrial products and as a source of supply of primary materials for the western European workshop. I don't remember the figures, exactly. My impression is, the total amount of trade between western Europe and eastern Europe never exceeded something like 3 or 4 billion dollars worth. The total trade of western Europe with the whole of the rest of the world, including its own colonies amounts to something like 25 billion dollars. It is not the dominant trading area for western Europe. It wasn't the dominant trading area even before the war, partly because eastern Europe was a very low-income area; it couldn't buy a whole lot.

Now, what has happened is reasonably clear. The Soviet policy has been to cleave as closely to autarchy as possible. That has been its program right along. It is perfectly clear that the soviets regard foreign trade as a bad thing on the whole. It makes them dependent on other people. They are trying, with more or less success, to impose that policy on their satellites.

At the same time we have been really moving in the same direction in this country. We couldn't care less whether we trade with the Soviet Union, because we don't feel our economy benefits very greatly from such trade. So we are perfectly willing to embargo exports to the Soviet Union and to its satellites. Just as there is some tension between the Soviet Union, which does not need trade very badly with the outside world, and its satellites, which do, there is tension between ourselves and our partners in western Europe who are very anxious to continue this trade with eastern Europe.

Now the character of the trade is important to understand. I am sure you are studying this in connection with your present project. The character of the trade is that the Soviet Union wants to import what it does not have, which is mostly skilled labor and management. Therefore, what it wants to import in particular is the products of skilled labor and management which, for the time being, until training programs under way come to fruition, cannot be duplicated in the Soviet bloc. So the whole emphasis of its policy is on importing heavily processed stuff--precision machinery, machine tools, and that sort of thing. It so happens that this kind of stuff is, in the definition of the Battle Act, pretty "strategic," and rather important for its war potential.

On the other side, of course, the trade is mostly in primary materials --food, lumber, and the like. What our policy ought to be toward that trade I think has to be conditioned largely by what we think the Soviet Union really is up to. I don't think we can expect that over a long period of time, assuming a continuation, more or less, of the cold war situation we have now, the Soviet Union will want to do anything except continue to contract that trade as rapidly as its own internal development progresses, as rapidly as it can substitute for this trade the development of its own skilled labor, management, machine tools, manufactured equipment, and so on.

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So we have to realize, I think, that pushing more trade with the Soviet bloc is likely to be both very difficult and, in the long run, unsuccessful, because the Russians will gradually choke it off anyway. It is not their announced policy; their announced policy is usually the reverse.

Now, if that is a correct analysis of Soviet intentions, it seems to me the main thing we need to do about East-West trade is to find good substitutes for it, rather than to bat our heads against a stone wall. Again, this is a personal opinion. There are many people even in MSA who would disagree with me. This is not primarily for strategic reasons. I don't think the amount they get from western Europe is really of great significance in their total war program. I think the concept of the Battle Act which treats our whole assistance program, including the military assistance to Europe, as existing for the explicit purpose of being cut off if we don't like our allies' trade policy, is a distortion of values in the making of foreign policy.

The general prejudice against a large volume of trade between the Soviet bloc and western Europe, the general congressional prejudice, I think we have to share, for reasons completely different from those used to justify it on the Hill. We have to share it because it is a fact of life that Soviet policy, unless we figure out better ways of changing Soviet foreign policy than we have been able to do so far, is going to continue. We notice in the reorganization that the man particularly identified with this policy of choking off trade, Mikoyan, is still very much in evidence as the chief trade controller and has in fact been made a deputy premier. It doesn't look as though there has been much change on this front since Stalin's death.

QUESTION: I would like to ask a question concerning the general conditions you have described in Europe. What is the impact on the Europeans' ability to rearm themselves: What hindrances do these conditions create?

MR. CLEVELAND: I'm afraid I rather neglected that for a time in trying to give the general picture of Europe's relationship with the rest of the world, which is the primary limitation. When Korea first came along, there was a double impact on Europe. First of all the raw materials, on which Europe depends for operation of its workshop, went up wildly in price as a result of our demand for them; so the terms of trade turned rather sharply against Europe.

At the same time some of the countries, particularly the United Kingdom, were able to get some advantage out of that, because the United Kingdom controlled the sterling area, and France controlled its French Union. These areas particularly got a big windfall out of prices for these raw materials.

Coming along about nine months later, because the European program didn't come along until about nine months after ours got under way, you began to get the impact, more specifically in Europe, of the deficiency in manpower, facilities, and so forth, in making soldiers, making munitions of war and equipment, and building military installations.

Now this deficiency of resources is serious in Europe for a rather special reason. I keep saying Europe is a workshop; that is the reason. Take the UK as an example--the United Kingdom is making most of its own weapons of war; we give the United Kingdom a relatively small amount of military assistance because its people can make most of what they need themselves. But this manufacture of munitions constitutes a sizable claim on the total amount of capacity in what they call their engineering industries, what we would call their mechanical and electrical industries. These engineering industries are also the basis of England's export drive now that textiles are declining as a big earner abroad. So the main things that England can depend on to earn foreign exchange to buy the raw materials it needs are the products of these engineering industries.

At the same time these same engineering industries are the basis of England's investment program for growth, since the British make most of their own machine tools and investment goods. So here is this tight group of engineering industries chocabloc with orders from manufacturers who want to expand their capacity, from exporters (including exporters who are not going to pay anything in real terms for it because they are using those war debts as a means of payment), and also from the Ministry of National Defense.

Now, there is no solution to this other than the expansion of the engineering industries as a whole. This itself requires diversion of the resources within the engineering industries to more machine tools and less finished equipment, military equipment. Competition for capacity is very real and very difficult. The same factory that makes Austins for the United States market or the Argentine market can make a Centurion tank. They are going to make one or the other; they are not going to make both with that factory this year. So this competition is more than just the diversion of 10 percent of the national product in general to military purposes.

It is more serious than that, because the load of the military demand is so heavily, in the British case, on hard goods production, and hard goods production is what they depend on for internal growth and for successful exports. On the Continent it is a slightly different kind of problem. They don't produce their own equipment; we provide most of it. There the crucial element tends not to be the production of hard goods; the crucial element tends to be the budget--the financing of the operation of the economy by the government. This is why you are constantly hearing about budget crises in France, and its successive prime ministers trying to find how they can fit into a budget all the things they would like to do plus a big rearmament program. In fact in France it is no longer a problem of imports. The French are getting all the imports they need. They are getting all the imports they need and piling up dollars in the central bank. The limiting factor is their internal financing, the ability of the government to find enough francs to cover all their claims.

What happens, of course, is that they do find the francs by running the printing presses, which causes inflation, which squeezes the civilian population in just those places, the urban workers, and so forth, that are socially the most disruptive element when squeezed. So that in France the impact of rearmament produces communism.

But in both cases--these are really the two major cases--it is to our interest in the United States not to have the total load on the British economy and on the French economy too big. If we make it too big on the British economy we find that they are not able to export and buy the raw materials they need to have. In the French case if we make the load too great, it produces social dissentions in the society which may mean the whole French rearmament program would come a cropper as it did in 1940.

So this problem of the balance of civilian versus military use of resources inside each of the European countries is today a major preoccupation of the U. S. Government. There are literally hundreds of people in the U. S. Government, as some of you know, who are working here and in Europe to analyze the internal economy of each of these countries and advise the governments about their budgetary problems and internal affairs, which previously would have been regarded as an unacceptable degree of intervention. Our responsibility for the size of the rearmament program as a whole--because we are by such a large margin the biggest contributor to it--is what causes this degree of intervention in the internal situation in the European countries.

QUESTION: Sir, going back to your big fact number five, I would like to know what the definition of an underdeveloped country is. You mentioned Australia and Argentina, I believe, as examples, and of course it is obvious that many countries are underdeveloped. How do you go about telling which countries are underdeveloped? What does it mean? Are they underdeveloped industrially or technologically?

MR. CLEVELAND: It is a loose word. In the MSA we made a policy and called all countries less-developed areas. What I meant by the term was roughly the rest of the world outside the United States and Europe; and the rest of the free world relative to western Europe, the United States, and Japan--these areas are really the industrialized part and are relatively underdeveloped in the sense that they have a greater dependence on primary production. They have a lower per capita income. They are poorer in almost any sort of index you want to take. The reason they are poorer is that they have not, to the extent that we have and the Europeans have, applied the results of modern science and technology to the process of production--to put it in the most theoretical way.

QUESTION: If everybody makes everything they need to be industrialized, the only trade will be in raw materials; and only a few countries have those.

MR. CLEVELAND: Well, I didn't, of course, mean to imply that everybody ought to make everything they need themselves. The principle of comparative advantage among countries is still a good economic principle. Countries are going to want to produce more than what they use themselves. To a point which is efficient, they have to do so. The point I was emphasizing was this: We should not assume, and we should not encourage them to assume, that the road to progress in the second half of the twentieth century is the same as the road to progress in the first half of the nineteenth century; namely, to industrialize like mad and not produce raw materials.

The world has gotten just about to the point now where it will get seriously diminishing returns from rapid industrialization unaccompanied by rapid production. This seems to be a huge fact of life and one that we have to live with. What is important is that we don't apply to the problem of the next few decades a criterion which would have been fine if we were living in the first century of the industrial revolution.

COLONEL WATERMAN: As usual, our time has run out. You have given us a very penetrating look into this problem. I thank you very much.

(24 June 1953--350)S/rrb