

REGIONAL AND INTERNATIONAL TRADE

6 September 1955

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Dr. Howard S. Piquet, Senior Specialist in International Economics, Legislative Reference Service, Library of Congress, was born in New York City in 1903. He received his bachelor's degree from New York University, 1924; Master's from the University of California, 1926; and Ph. D. from Princeton University, 1930. He has taught economics at Princeton University, New York University, and Rutgers University, University of California, American University, and the University of Oregon. In 1934 he joined the economics staff of the U. S. Tariff Commission and became Chief of its Economics Division in 1937. He served in this capacity until 1943 when he became Executive Secretary of the United Nations Interim Commission on Food and Agriculture (the forerunner of FOA). In 1945 he joined the staff of the Office of War Mobilization and Reconversion where he served as Executive Secretary of the Interagency Policy Committee, on Rubber. Since 1946 he has been Senior Specialist in International Economics at the Legislative Reference Service. In 1947 he was detailed to the Foreign Affairs Committee of the House of Representatives and served as Deputy Staff Director of the House Select Committee on Foreign Aid. He has been detailed, at various times, to the joint Committee on the Economic Report and the House Committee on Interstate and Foreign Commerce as well as to the Public Advisory Board for Mutual Security (Bell Committee) and the Commission on Foreign Economic Policy (Randall Commission). Dr. Piquet has written several books and numerous articles on economic questions. His latest book, "Aid, Trade and the Tariff" was published in 1953 by the T. Y. Crowell Company.

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DR. HUNTER: General Hollis, General Calhoun, gentlemen: So far in our economics course we have been preoccupied both in our lecture program and in the discussion periods with problems that are primarily domestic or internal in character. This morning we turn to a set of problems of a different character--those concerned with the relationship of the American economy to the economies of other nations and to the world economy.

There was a time perhaps when we in this country were inclined to regard our international economic relations as of relatively minor importance. But it has become very apparent since 1945 that the security of this country may very well depend to an important degree upon the skill with which we conduct this phase of our relations with other nations.

Now, our speaker this morning, Dr. Howard S. Piquet, will talk to us on problems of regional and international trade. Dr. Piquet has a distinguished record of government service and of research and publication in this varied field. His association with the Industrial College goes back to 1944, almost the very beginning of the reactivation of the Industrial College. This is his seventh lecture here.

It is a pleasure to have Dr. Piquet back with us again this morning. Dr. Piquet.

DR. PIQUET: It is always a pleasure to come to the Industrial College, where I feel like an old friend. I found out this morning that your new Commandant, General Hollis, was a student here some years ago and listened to me then. So, I really feel like an old school teacher.

I call myself a political economist. I don't mean that in any sinister sense. I mean it in the sense that my daily work brings me into close contact with the political process at the Legislative Reference Service, where I happen to be Senior Specialist in International Economics. Our only job is to advise Members of Congress, and committees. In my particular case the assistance is in the field of international trade and international economics.

Working for Congress means that we have to be extremely honest. We work for both sides, Republicans and Democrats alike. I have found that of the two alternatives: the one of doing nothing and being a vegetable, and the other, being honest, saying what can be substantiated, the latter is the more comfortable. At least, I have the feeling that I am still a human being, that I am still presenting what I myself believe in the light of my professional training and experience.

This morning I shall discuss the subject of interregional, or international, trade. I am going to discuss the subject under three main headings. After stressing the importance of the subject in general, I shall discuss the present international economic position of the United States, contrasting our position today with that of the United Kingdom approximately a century ago. Secondly, I shall discuss the free trade theory and its limitations. Thirdly, I shall consider the evolution of United States trade policy from 1921 to date; and then end up with some conclusions and a few proposals regarding national policy.

Now, I can't think of any subject more important than the relationship between the United States and its Allies. If I thought that the question of international trade involved only the traditional debate between "protectionists" and "free traders," I wouldn't waste my time writing on the subject or talking to you about it. As I see it, the subject is second in importance only to the problem of national military security itself.

Think how foolish we would be if we were to put all of our eggs into the basket of military security alone! Not that I would for one moment, because of the friendly mood of Russia at the moment, cut our military preparations. Not one bit. This is the time to "keep our powder drier" than ever. But the time is ripe for us to demonstrate to our friends that we want to deal with them on the basis of equality, particularly with regard to countries that are far beneath us with respect to levels of living, specifically, such countries as Japan and Italy. As long as they feel, these allies of ours--erstwhile enemies perhaps, but friends now--that they are not dealing with us on the basis of equality, we can't expect to have their genuine friendship. This psychological understanding can be more important than guns.

That is where trade comes in, because the opportunity to earn a living is second only to freedom in the hierarchy of human desires. People--at least most people--would prefer to earn their own way. They don't want charity. They don't like foreign aid any more than we do.

And yet we are conscious, I believe, all of us in this room, as are the people up on Capitol Hill, that, if we were to open our doors trade-wise to all the goods of Japan, we would have one mess of fish to deal with here at home. We are in a real dilemma.

The Legislative Reference Service prepared a report not so long ago--and I think you used it here at the College--entitled "Trends in Economic Growth, a Comparison of the Western Powers and the Soviet Bloc." If you have read it, as I hope you have, you will remember that in it we pointed out that the Russian bear is not twelve feet high, nor is he three feet high. Rather, he is about four feet high or four and a half compared with us. Russia, in terms of economic strength, is weaker than we are, even though she is growing more rapidly than we. She started out from a base so much smaller than we did that a given absolute increase means more in terms of percentage change than it does to us.

Even allowing her fifteen years, with her growing at 4 percent and we at 3--these figures don't mean too much. It looks as if she is growing a little more rapidly than we are. But, even though she is growing more rapidly, the arithmetical difference between her economic strength and ours will not be less, but greater, as the years go on. Time is working on our side, as the trend is now, at least for the next few decades.

There is thus no reason for us to fear the "normal" or peacetime, economic strength of Russia. By that I mean the capacity to produce such goods as refrigerators, automobiles, electric ranges, TV, and radio. Of course, we don't fight with those things; and we can have an awful lot of trouble if we put all of our economic strength into civilian goods. A small country, a much weaker country, can be a powerful enemy if they are geared to war while we are geared to peacetime consumption. Still, there is no reason for Americans to be panic-stricken over the economic growth of the Soviet Union.

Now, in fact, less than a year later, the danger is not that we will be panic-stricken, but that we will be a little too cocky, because the Russians have now turned on their smiling face. We must not pay too much attention to such changing moods. We need to recognize that, basically, Russian policy has not changed, and probably is not going to change.

This is where one of our main problems comes in. And here we should contrast the position of the United States today with that of Great

Britain a century ago, because very often we hear it said that, if only we were to act like Britain did in 1846, when she went on a free trade basis, we would then be playing our "proper" role in the world economy. Would that it were that simple.

One of the big problems is our very strength, our bigness. The United States economy is huge. We don't realize it ourselves sometimes. As the London Economist put it several years ago, "When the United States sneezes, Western Europe catches pneumonia." They are much more dependent upon us than we are upon them.

We are not conscious of a need for their goods. We are even disposed to oppose their importation, since they are often produced by low-priced labor. In fact, we are so proficient in manufacturing, that we can produce practically anything more efficiently than most other countries.

That is true of everything except a small number of commodities, which we hear about in the press all the time, such as bicycles and watches, which are what you might call tariff skeletons.

The total production of such commodities a few years ago was about 4 billion dollars a year. Compare this figure with our gross national product of some 370-odd billion dollars and you can see that we are discussing a problem which in the aggregate is very small. Yet, to the people who are hurt, or who think they are hurt, such competition is a very real thing. And these industries are distributed widely enough so that their political effectiveness is far in excess of what would appear to be justified by their place in the economy as a whole.

As I think I put it when I was here last year, if you are hurt, it makes no difference whether you are part of a large statistic or a small statistic. You are hurt just as much. These bicycle people have been in a very sad position. But it does not follow that the solution to the problem is to keep out imports. Maybe the answer lies in better management, with a willingness to adapt their product to changed demand situations.

The United States is so large and so effecient that it has what theoretical economists call an "absolute advantage" in the production of most manufactured goods. We are so productive that we can afford to pay high wages and still produce more cheaply than can most foreign

countries. That means that the only goods that can be imported, even in the absence of tariffs, are those goods that represent the low end of the efficiency scale in the United States.

Then, too, production practices in this country are often different from those of Western Europe. I am not saying that they are better or worse. I am simply observing a difference. You have noticed the storage battery in your automobile. In about eighteen months it usually goes out like that (snapping fingers). The electric light bulb also gives up at the end of the guarantee period. We have a new electric stove in our house and it will do the same. The philosophy is--and it is one thing that has kept our American economy at such a high pitch--to make things so they will wear out, to make them so they will soon become obsolete. They will make the 1956 automobile different from the 1955 so that you will realize that you are driving an old car, even though you bought it only a few months ago.

In Europe most of the economies are not geared to this practice. They might have given us more trouble if they were. European economies are changing, are becoming more like ours, as with the jet engine in Great Britain. But they still have an ingrained attitude of quality production, of producing things that will last. Thus arises stress and strain between our economy and theirs.

The United States, as I have said, is so large that it is scarcely conscious of any need for imports, except strategic goods. What we do need from abroad we need badly. But in terms of the total economy, our imports are unimportant compared with the importance of imports and exports to most foreign countries. In the case of Great Britain, for instance, foreign trade has accounted, traditionally, for over one quarter of their total national income. In our case it has never gone above 10 percent, and is usually closer to 7 or 8 percent. We are so big that, notwithstanding the fact that our foreign trade is relatively unimportant to us in the aggregate, we are still the largest trading country in the world

And yet the simple fact that I have just mentioned--this tremendous size of the United States economy--also offers hope for a way out of our difficulties, and I am going to try to end up this address on that theme.

As a result of all this, there has developed what has come to be known as the "dollar gap" or "dollar shortage." I don't like the term

"dollar shortage." I have had a dollar shortage as far back as I can remember. Everyone in this room has a dollar shortage, for a dollar shortage in the sense that dollars are scarce relative to the desire for them. But a "dollar gap" in the sense that the United States has international credits far in excess of its debits, is a very real phenomenon, and one that has been with us since the close of the war.

When we say that we have had an imbalance in our international payments to the tune of approximately five billion dollars a year for the last decade, we are in one sense violating the English language. For we cannot say that debits don't equal credits, because total debits must always equal total credits. This is what we mean by double-entry bookkeeping. The only reason why credits are greater than debits now is that we have been giving away the difference. In other words, the "dollar gap" is a direct function of, or the obverse side of, direct foreign aid.

In 1947 we could have avoided the dollar gap very easily if we had wanted to, by simply not having enacted the Marshall Plan. But if you go back in your memory to 1947, you will remember that the President convened Congress in special session in the fall of 1947 to pass what was called the Interim Aid Bill, in order to fill the pipelines of foreign aid to Italy and France, because they couldn't wait until Congress got around to the enactment of the full-fledged Marshall Plan, which came early in 1948. The situation in Europe was just that critical. It looked as though Western Europe was going Communist, and quickly.

Now the "gap" that is really important is the gap between the planes of living of the United States and those of our friends abroad. That is what has made it politically necessary to help raise these planes in order to help avoid political unrest. This is not a mere "accounting" imbalance.

When you hear people, as you sometimes do, say that we have to have foreign aid to the tune of so many billion dollars a year in order to fill the dollar gap in the accounting sense, you are listening to plain nonsense. If they say that we must continue foreign aid, or do some other thing, to stimulate trade, because of the political situation abroad, then they are talking sense. But talking about an economic vacuum in an accounting sense is a waste of time.

The dollar gap has resulted in a favorable position of the dollar vis-a-vis other currencies. Other countries have found exchange rates

turning against them. The British pound, for example, has deteriorated and is at its lowest point since the close of the war. The British economy is sick. They can't seem to get themselves moving; they can't seem to produce enough for export. Their imports are in excess of their exports, and they have had to tighten their belts more and more.

Therefore, you can expect in the next few weeks or months to see Britain impose tighter exchange controls. Maybe she will impose more quotas or tighten up on the imperial preferences. Yet we, in our lack of wisdom upon occasion, have criticized the British and other European countries because of their "immoral" habit of imposing these "evil" quotas and exchange controls.

Such restraints against the dollar are little more than devices for rationing scarce dollars. If they did not control their dollar purchases--not only England, but other countries as well who are confronted by the situation--they would find their dollars being dissipated upon luxury goods. Back about 1947 or 1948, when the Marshall Plan was being enacted, that was one of our main headaches--how to keep the French and Germans from buying such things as nylon stockings and radios. When the Marshall Plan was first put into effect, we actually included wine for France as a consumer-incentive good, because the French were so hungry for consumer goods that they were rebelling against the rationing of dollars for the purchase of the raw materials and foodstuffs that they needed. Such controls are part of the whole picture. The fact that there is a dollar shortage is evidence that the problem is largely an American problem, not just a European problem.

We have several choices that we can make. We can allow imports to increase, which is the logical thing to do; or we can just let the thing go, let nature take its course, in which case exports will decline. And that is not going to be good for agriculture, which is a headache both economically and politically right now.

Or we can continue foreign aid and keep sending money abroad. That is the simplest way; that is why we have been doing it for the past decade. It is much easier to appropriate taxpayers' money than it is to adjust to competition from abroad.

Or, as you hear so much about, we can increase foreign investment, as Britain did from the close of the Napoleonic wars until the 1870's. They played an important role in building some of the railroads in this country and a number of industrial establishments. For the next thirty years, while she was collecting on her investments, she had an import balance, like any creditor.

Presumably we could do the same thing. But that "presumably" is a big "presumably." The trouble is, why should persons with capital invest abroad when investment is so profitable at home? Why should I send my dollars abroad, with Russia in the picture, when I can get a handsome return on my General Motors stock or my Chrysler stock or my AT&T stock here at home?

The chance of solving this problem by increasing foreign investments is remote. In final analysis, the problem must be solved by one of the three methods that I have mentioned, or by some combination of them; i. e., allowing exports to decrease, permitting imports to increase, or continuing foreign aid.

I doubt that the continuation of foreign aid on a large scale is in the cards. It seems to me that, with discontent from both recipients and donors, it has largely outlived its usefulness.

One hundred years ago, when England was behaving as I have mentioned, the period came to be known as the "Golden Age." When you look back at it, the 19th century does look good--there were no atomic bombs, no television, no automobiles. Life was simple--I suppose. But, in any event, on the economic side, it seemed to be self-regulating; in fact, so much so that it came to be looked upon by the economists of the classical persuasion as being some sort of a "natural" system.

What did this mean? First, it meant that most countries were on a gold standard basis. Gold was the currency everywhere. The British pound sterling was convertible into gold. Vice versa, gold was convertible into pounds sterling. Furthermore, the world was at peace. There were no major wars throughout the century outside of the U. S. Civil War, which was local. The British Navy was always around. It was the period of "Pax Britannica."

The system worked well. As long as trade was not too much out of balance, so that British exports were in excess of imports, or vice versa, the exchange rates would effect adjustment. The "par of exchange" under the gold standard system was simply the relative gold weight of currencies. In those days the gold in the British pound sterling was 4.866 times as heavy as the gold in the U. S. dollar. As the exchange rate moved, the gold would move and equalize the price levels in the two countries.

But, even before the gold moved, the market was so sensitive that there would be an adjustment brought about by short-term capital movements. So the exchange rates seldom got beyond the gold points, which is to say, not beyond about two to four cents away from "par." The exchange rates were stable, which facilitated trade immensely.

Without going into all of the reasons why, this situation no longer prevails. Great Britain is a small country. Her imports and exports constituted, as I said, a very substantial proportion of her national income. Therefore every cockney on the streets of London was conscious of the necessity of importing food from abroad. If they didn't have imports, they didn't eat well. They needed raw materials from their far-flung empire, as well as from other parts of the world.

Therefore the British people don't deserve too great credit for having thought through the theory of a world economy. It was brought about by obvious self-interest. It was brought about by the insularity of Britain and by the fact that it was the first country to experience the Industrial Revolution. For a long period Great Britain was the only important manufacturing country in the world. But in the latter part of the period, of course, the Germans and Belgians and later the Americans became competitors.

Contrast the situation today with that. The United States is not an island, but a continent. It is virtually self-sufficient, the most self-sufficient country the world has ever seen. We are not entirely self-sufficient to be sure; but we are so much so that the man in the street is not conscious of the need for imports.

Therefore, if the United States is going to accept leadership in the international economic field, it is going to have to do it on the basis of reason. It will require national intellectual effort and it is a real question whether we can do it.

Also today we don't have a peaceful world. There are wars all over the world--cold, hot, and lukewarm.

In the 19th century the world was organized on the basis of small economic units, what the economists call pure competition. There were no large cartels, no huge corporations, as we have today.

I was in Detroit about a month ago, where I visited with representatives of some of the motor companies. General Motors makes--I

almost said they make everything except automobiles. They still make automobiles, but they make many other products too. The dominant characteristic of industrial production today, particularly in the United States, is the giant integrated corporation, producing a full line of merchandise. So that instead of an economy equilibrating itself automatically on the basis of a large number of little competitors, we have a few big giants whose relationship with each other is that of watchful rivalry. General Motors, Chrysler, and Ford are watching each other as carefully as, if not more carefully than, they are watching their own internal operations.

Furthermore, Government has stepped in to do for agriculture what agriculture has not been able to do for itself--to introduce monopoly into the picture.

Thus, we hardly have free enterprise in the rigid sense of the term. We have an American system, which is a mixed system--some government controls and a lot of freedom. We have an American system that is evolving but it is a far cry from mid-Nineteenth-Century Capitalism. And for this we should be thankful.

This leads me to my next point, which is the free trade theory and its limitations. A theory which was evolved at the turn of the 18th century, and which was expanded and refined in the first half of the 19th century. I refer, of course, to the works of Adam Smith and John Stuart Mill, who wrote respectively in 1776 and 1848. I might say, by way of footnote, that, if they were alive today, they undoubtedly would propound different theories. They prescribed free trade in order to maximize the wealth of the nation, which seemed logical in the light of the conditions of the times.

It is a very simple theory. Let us suppose that I can write an article for a magazine in a week and get a thousand dollars for it. (I don't mean that I can, but suppose that I could.) Suppose, also, that I am a good handyman around the house; I can fix up things better than anybody else that I can hire to do the job. I also am a better typist than anyone in the area. Which would it pay me to do--to do my own typing, fix the plumbing, clean the furnace, and mow the lawn, or to concentrate upon writing? Obviously, it would pay me to concentrate on the thing that would bring me the greatest return. I should continue writing for a thousand dollars a week and get the next-best stenographer to do my typing and the next-best mechanic to clean the furnace. That is what we mean by the Principle of Comparative Advantage.

I should do that not only because I have an absolute advantage in all three lines of activity, but I have a comparative advantage. That is, I have the greatest relative advantage in the thing that pays the most, which is composing the article.

Let us take a second illustration. Assume that there are two beehives. One is in the valley, where there are lush flowers. All the bees have to do is to go out in one trip and bring in all the nectar they need to make their honey. The other beehive is perched up on the mountain top, where there are only a few little mountain flowers. Those poor bees have to work very hard to get any honey at all. Those bees up on the mountain top have a small "gross national product," a poor national income, those Italian and Japanese bees; whereas in the valley we American bees enjoy a very rich environment. We know how to make honey too and the result is that we have a high national product or national income.

The return from a unit of bee effort in getting nectar to make honey is much greater in the valley than it is on the mountain top. The profits and wages, considered together, are much higher in the case of the United States than in the cases of Japan or Italy. In fact, high wages are a pretty good indication that the national product of a country is high, not low. God help us if our wages ever get to the standards that apply in Italy and Japan! We should be thankful that we have a high wage system, for it means we are productive.

Now, of course, if the bees migrated, so that the Japanese bees came into the United States, then there would be equalization. Our wages would go down and theirs would go up. In a book just written by Dr. Lewis Lloyd, a chemist and self-trained economist with Dow Chemical Company, it is stated that the free trade theory depends upon free mobility of labor and capital. Nothing could be more incorrect. The very principle of regional and international trade is that labor (and capital to a degree) will not move.

That is what the economists meant when they said that foreign trade, international and regional trade, is trade between non-competing groups. Those bees on the mountain top do not compete with the bees in the valley. But their honey competes with the honey of the valley. In other words, the principle is not that labor competes with the products of labor, but that labor competes with labor. American labor does not compete with the product of European labor. That is an elementary lesson in economics.

There is nothing logically wrong with the theory of free trade on the basis of the assumptions upon which it is based. To try to disprove the theory of international trade or free trade by picking holes in its internal logic is a rather futile performance. The important question to be faced is whether the assumptions upon which it is based are in accord with the facts of the middle of the 20th Century. I believe that a reasonable person would have to admit that economic conditions today are vastly different from what they were a century ago. The economy is no longer purely competitive and governments no longer abstain from interfering with the working of the economy.

The tariff has long been a hot political issue in the United States. Traditionally, the Republican Party has been the party of "Protection" and the Democrats have been associated with the "Free Trade" doctrine. In fact, today, both parties are widely split on the issue. In practice, our tariff policy has not had much to do with the country's prosperity. The country is so big, so wealthy, and so productive that the damage done by our adherence to Protection has not been very great. But, to attribute this prosperity to the tariff is to magnify a mole hill into a mountain.

After World War I we saw the necessity of helping the chemical industry, because the Germans had given us a good run for our money in World War I. So, starting in 1921, we gave special favors to it. We are still doing it.

In 1930 we passed the Smoot-Hawley Act, which was the highest tariff in our history, with rates ranging as high as 400 or 500 percent on a few items and with numerous other rates between 100 and 200. Then came the Great Depression of 1930. I shall not waste your time arguing which was cause and which was effect. They came together, and they had a great effect on other countries.

Starting with 1930, conditions got worse, and the Republicans got weaker and weaker. Finally in 1932 the Democrats assumed the Presidency and control of Congress.

In 1934, after over a year of debate, the Democrats came up with a new formula known as the Reciprocal Trade Agreements Act. It was the brain child of Cordell Hull, who himself had been a member of the Ways and Means Committee of the House and subsequently a Senator who had had exerted on him all the pressures that only tariff lobbies can exert. As Secretary of State he proposed the Trade Agreements Act,

authorizing the President to enter into trade agreements with other countries whereby, in exchange for the lowering of their trade barriers, we would lower our tariffs to the extent of 50 percent on a commodity-by-commodity and a country-by-country basis.

That act was passed. From 1934 until 1947 a large number of individual trade agreements were entered into after very careful study. The results were not too specific, because other forces were at work also. Whether the increase in trade was due to trade agreements or not, nobody will ever know.

In 1945 the President's power to reduce duties was increased to 75 percent. This encouraged the Administration, and by 1947 Cordell Hull was out of the picture. Newcomers in the Administration, feeling buoyed up by the success of the program, decided they might step on the accelerator a little more. So, starting in 1947, they embarked on the multilateral negotiating method. At a meeting in Geneva in that year, the General Agreement on Tariff and Trade was signed, the so-called GATT.

If we had a parliamentary form of government, under which the Cabinet was responsible to the Parliament or the Congress, then I think we would all have to say that we are really making progress. But, under the circumstances, it is a question whether the change in direction in 1947 didn't do as much harm as good, because in the very same year (1947) in which the Administration embarked upon a new and ambitious program of multilateral negotiating with a large number of countries, Congress insisted that an "escape clause" be written into all agreements. And later on, two years later, they passed the "peril-point" provision, whereby the President must explain to Congress why he lowers the duty if he goes beyond a predetermined point, below the tariff agreed upon in the formula. So since 1947, the Administration has been speeding up the lowering of tariffs, while Congress keeps telling the Administration to "go slow." Even the Democrats joined the Republicans in this.

In 1951, when the Democrats were still in control of Congress, the "escape clause" was written into the legislation itself. The parallelism is too close to be accidental.

Cordell Hull's philosophy has not been adhered to. His idea was that if you drip water slowly on a rock, you will wear a hole through it eventually. He never compromised, not once. I have heard him

testify before the Ways and Means Committee. He knew every angle. He knew every member of the committee personally. They tried to make him compromise, but he flatly refused to compromise.

Since 1947, Congress has become alarmed and so have the people, because they feel that the Administration is lowering all duties without regard for the consequences. Whether it is being done carefully or not I don't know. I know it is being done more rapidly. Instead of a dripping of the water then, it is a big cascade now.

A lot of things have happened since 1948. The escape clause has been strengthened. Sometimes I think that the Trade Agreements Act today is being used as much as a protectionist device as it is as a device for liberalizing trade policy, because of the operation of the escape clause provision.

In 1950, as you may remember, Congress enacted the so-called "Cheese Amendment" to the Defense Production Act, which stated that, in order to maintain the domestic dairy industry at a level which in the opinion of the Secretary of Agriculture is necessary for the defense effort, he may invoke a licensing system on imports of cheese and other dairy products. We are now on a full licensing basis with regard to the importation of cheese. So when we point our finger at these other countries for their naughty behavior, we should remember that we live in a glass house too. We have in fact a quite elaborate quota system in this country. Even though the quotas are part and parcel of our agricultural program, they are quantitative trade restrictions, nonetheless.

Every country in the world has a reason for imposing trade restrictions. The only trouble is, we look upon our own reasons as legitimate and other countries' reasons as phony. It is so much easier to do it this way than to analyze the thing on the basis of honest self-appraisal.

Foreign countries are looking at us with their tongue in their cheeks. If you have noticed some of the cartoons by Herblock, you know what I mean. The other day he had one showing a motorcycle going full steam ahead, with the tariff boys in the drivers seat, going fast, the President facing backward in the rear seat reading a book on free trade, and the poor little public wondering what it is all about. In concrete cases we seem to be disposed to cave in to the people who want favors from Government.

Let me cite as an illustration this recently adopted H. R. 1, which is the embodiment of some Randall Commission recommendations, which themselves were compromises. About a year and a half ago, the Randall Commission was appointed. It consisted of seventeen people, ranging all the way from Richard Simpson, Dan Reed, and Senator Milliken, all ardent protectionists, to such decided freer traders as Jere Cooper.

Their job was to come up with policy proposal, and they did. Fourteen out of the seventeen agreed. The moderate protectionists agreed with the free trade people. The only ones who held out were Messrs., Milliken, Reed, and Simpson. The majority proposed a reduction of the duties of 15 percent (not 15 percentage points but 15 percent) over a period of three years. It was like taking a knife and peeling a potato very thin. If every duty were to be lowered 15 percent, the effect upon foreign trade would be practically negligible.

Also included in the Randall Commission recommendations was a proposal that duties could be cut by 50 percent on goods entering the country in negligible quantity or not at all. This provision was eliminated by the Senate.

It was also provided in the Randall recommendations that duties in excess of 50 percent could be lowered to 50 percent. Some duties at that time were as high as 100 or 125 percent, and even 336 percent on spectacles and eyeglasses.

So we really now have two tariff policies--the Administration's professed policy of lowering duties to increase trade, and the policy of Congress, which is not to injure any one by tariff reduction.

In foreign aid we have done a pretty good job, as witnessed by the Marshall Plan, UNRRA, Postwar Aid to Undeveloped Countries, FOA, the United Nations, and economic and social organizations like World Health and ILO. Yet the international trade issue, which we have not yet faced squarely, is the very keystone of the arch of international relations.

What can we do? There are at least several formulas that have been proposed. Let's take the situation of Japan. Japan can produce many things at less cost than we, owing to lower wages.

However, to talk about a small country like Japan undercutting the United States economy as a whole is rather ridiculous. It is like saying

that the beehive on the mountain top can throw the efficient beehive in the valley out of business. It doesn't make sense. On specific commodities, trouble arises because the wage rates in Japan are so low. But, in the vast mass of machine-made goods Japan cannot compete against U. S. industry.

Why can't we think up some formula whereby we could increase imports from Japan on a planned basis? We don't have to cut the duties on all textiles in order to let some Japanese textiles come in. In fact, we had an arrangement--a "gentleman's agreement"--with Japan just prior to the war whereby Japan voluntarily restricted her exports of cotton textiles to the United States.

Secondly, we could have a system of tariff regulations such as we already have with respect to certain fish and dairy items from Canada. We have lowered the duty on fish and on whole and dried milk until imports reach a certain amount; then the duty reverts to its former level. We could do the same thing with Japan on things that don't now come from Japan, such as typewriters and power lawn-mowers. It is not now worth the effort for them to get into the market, because by the time they learned to make good typewriters--and they could--someone would cause the escape clause to be invoked, and they would be left out on a limb.

But we could tell Japan that we will limit them to 5 or 10 percent of the American market on typewriters, not a free market, but that we will do nothing to keep out their imports until they get up to this percentage. Five percent of the American market is a tremendous amount to Japan, probably as much as they could possibly ship. We are a big market. We are a big country and they are small. By our doing a little bit, we can be doing a lot for them, in giving them an opportunity to get into our market up to a limited degree.

Now, some such formula would be possible. No effort has been made to think of anything other than the old protectionist versus free trade fight.

Some people might say that this would violate the most-favored-nation policy, to which we have adhered since 1923. My answer is, "So what?" Is not the problem important enough and unique enough to warrant a solution? We already give preference to Cuba and the Philippines. If the countries of the free world should decide that because the Japanese situation is unique, politically and militarily, as well as economically, a unique solution is in order, what would be wrong with it?

Another possible solution, proposed by David McDonald, who was a member of the Randall Commission and who is President of the United Steel Workers Union, is for so-called "adjustment assistance!" In cases where imports hurt industries whose production is necessary in the light of the international situation, if they can demonstrate that they have been hurt, the Federal Government will step in and, not subsidize them, but help them get into new lines of work, arrange for business loans, supply supplementary unemployment compensation, etc.

I want to end up on this note: Foreign trade is important, not just economically from the point of view of the United States, but from the point of view of a strong free world and our own survival. It, therefore, has tremendous political overtones; and we seem to be doing precious little to face up to it.

We need not be ashamed of what we have done during and since the war. Winston Churchill said that the Marshall Plan was the "most unsordid act in human history." I think we have done a marvelous job, but not marvelous enough. We must recognize the international economic obligations that have been forced upon us.

DR. HUNTER: All right. First question.

QUESTION: Doctor, recently there has been a considerable effort on the part of some Congressmen, and, I think, the Administration, to use surplus agricultural commodities by selling them and creating credits in foreign countries and using those credits to build military facilities for the American forces. I can't be convinced yet that we can go very far with that without upsetting the world free market for those same commodities. What is your opinion on that?

DR. PIQUET: It has some of the characteristics of boot-strap economics. It is provided in the law that it must be done so as "not to interfere with the normal channels of private operation."

It has very limited usefulness. It is one of those things that sound attractive. If you sell surplus commodities for soft currency, which the law provides, you are usually displacing what would be otherwise done in the normal channels, almost inevitably. I think that it is pretty much a political operation and not a very promising solution to any economic problem.

QUESTION: Dr. Piquet, after reading our assignment over the week-end, I came in this morning an ardent free trader. Now I am not so sure. You talked about conditions that made the law of comparative advantage work well in the early 19th century, but which are not so applicable today; but you didn't elaborate further. Could you give a little more detail, so I may make up my mind?

DR. PIQUET: I pointed out, first of all, that one of the assumptions or premises that prevailed in the 19th century was a peaceful world. We don't have that now. Secondly, in the 19th century, conditions were "purely competitive." They didn't have large economic combinations of producers. There were a large number of small manufacturers and artisans, and the market place determined the price. It was an automatic-equilibrium type of economy, whereas today we have large aggregations of capital in the form of mammoth corporations. On top of that we have cartels that cut across national boundaries. Sometimes corporate entities are so big that they even transcend national boundaries. There was nothing like this prior to the 20th Century. Then, too, there are government controls on agriculture. World trade in agriculture is far from being open and competitive. It is governmentally dominated and governmentally controlled. You have minimum wage laws and social security of all kinds. The economic organization is quite different from what it used to be. It is no longer a purely competitive system on a self-equalizing basis, based on self-interest operating in the marketplace. Old Adam Smith said, "If you just let people alone, they will work this out without government interference." It would be as if an invisible hand were guiding them. But that invisible hand today does some funny things.

QUESTION: The old basic law is still there, isn't it?

DR. PIQUET: The logic is there. Given the assumptions that I mentioned, this logic of the beehives, it seems logical to me; but it is not unassailable. It is just plain ordinary deduction, like two and two make four. It is simple mathematics. But, as with any mathematical proposition, demonstrations in terms of deductive arguments or logic are no better than the assumptions.

QUESTION: Doctor, the Canadian dollar has kept up its value throughout the world, similar to ours. Would you comment on the major difference in the Canadian tariff policies and ours?

DR. PIQUET: They are not so vastly different. Canada is part of the British commonwealth system, but she is still more closely

geared to us in some respects than she is to Great Britain. She is not a member of the sterling bloc, in other words, She is a member of the dollar system.

The reason why the Canadian dollar has been so strong is because the Canadian economy has been strong. The Canadian economy has been a booming economy. As a matter of fact, such foreign investments as we have today are very largely in Canada. I think that is the simple answer to your question.

QUESTION: I, too, am thinking of our agricultural surpluses and our stockpile program. Would you care to discuss the economics of international trade under conditions of barter, which is engaged in by many countries, principally the Soviet Union?

DR. PIQUET: I don't know just what you want me to say on that, because the barter system is a crude system and one that is a makeshift for a more refined system.

Nobody likes this barter system. Nobody likes this controlled system. We would all like to go back to the 19th century system. But I would like to amend what I said about this being the best solution to the current problem, to this extent: We must not stop pushing for the restoration of some sort of world economy. But we can't wait until we get it.

Barter, at best, is a makeshift. Internationally it would be a lot easier than it would be among ourselves. Even if I were dealing in potatoes and you were dealing in cabbages, it would be difficult for us to find somebody who wants to barter cabbages for potatoes. But internationally there can be a lot done by this barter system, in the way of exchanging one country's surplus products for those of another. We did this regarding cotton. We exchanged cotton for rubber some years ago, as you will remember, to the advantage of both parties.

I would hate to think of the world not being able to do anything better than to rely upon the barter system, however. But, if we could help Japan by bartering some cotton for some Japanese manufactured goods, I would be all for it. I am for anything that will actually help develop markets. But it is a crude way to go about it.

QUESTION: Doctor, I have two questions. On this great surplus of cotton, wheat, butter, and everything, I want to put it a little more

bluntly and ask you, What do you as a political economist think will happen to these surpluses? There is going to have to be an answer.

DR. PIQUET: You don't want a political economist; you want a soothsayer. I left my crystal ball home this morning. I can't predict what is going to happen.

I suppose that what you are really asking me is what is the solution to this agricultural problem that has been with us for a long time. It is not a new problem. It has been with us since the twenties and even earlier. Therefore, as so many economists have pointed out, in agriculture we don't have the automatic adjustments that we have in industry, even under a purely competitive system.

Some of my own relatives were farmers. They didn't have all these agricultural controls. My uncle would listen to the radio, hear that they were going to have a bumper crop of potatoes over in New Jersey, and what did he do? Did he plant less potatoes? No, because he knew he was going to make less per bushel. Therefore, he planted more!

But the agricultural problem in itself is aggravated, because there is no place for the farmer to go. Factories don't attract him; he stays on the land. Then on top of that, you have this mechanization of the large farms, which means the little farmers are even harder put than they would be otherwise.

I can't answer your problem; I wish that I could.

QUESTION: Do you think the Japanese will be content to market their output in the free world market, or do you think it will be necessary for them to resume trade with Red China?

DR. PIQUET: That is a nice question. Of course we all realize that the logical market would be Southeast Asia, more so than the mainland. But Indonesia and that whole area is pretty poor. Even if we were to wait for a Point Four type of development to work out, we would have to wait a long time before Southeast Asia becomes a real market. Therefore Red China immediately looms up.

I think if we were to work with our own businessmen and with the Japanese Chamber of Commerce in New York, and with Japanese businessmen, we could make a considerable dent in this problem

without hitting the vulnerable spots in the American economy. I would try to encourage imports in these lines where we are strong. That is why I mentioned typewriters. If there is one big asset which the Japanese have it is their ability to mimic and to copy. They can produce fine merchandise if they are encouraged at it. It seems to me important that we encourage them. I don't think we have to go on an all-out free trade basis with them, but something can be done even within the framework of a protected American market.

QUESTION: As a matter of national defense, this question of international trade looms up. Before the war I was out on the West Coast and saw ships carrying oil and scrap steel to Japan, and I used to wonder whether this was a smart thing for the country to do.

DR. PIQUET: We got it all back--unfortunately!

QUESTION: When the war came, I knew that it wasn't. I have a feeling that when we trade with another country, we are likely to weaken ourselves and strengthen that country. Would you care to say whether that is correct?

DR. PIQUET: I would say it is incorrect.

QUESTION: In this particular case could you discuss the situation with Japan in 1938 and 1939?

DR. PIQUET: Let us be very frank about it here. You fellows here fought against Japan. Today we call Japan our ally.

We can't make things the way we want them in this world. We have to choose between alternatives. Which is worse--or better--that we should welcome Japan into the family of free nations as an equal--or throw her into the lap of Communist Russia and Red China? It is the lesser of two evils. That is my answer to the question.

Of course, if we figure that Japan is going to be fighting against us again, we are fools to be sending her scrap iron and oil. But if we feel there is a chance--and it is a calculated risk that we are taking--that if she does re-arm, and if we treat her friendly trade-wise--give her a break as an equal--she will be our ally, then I would say that trade is all to the good.

But you can't take an ideal situation. The world isn't built that way. So I don't think we have much choice.

QUESTION: Doctor, you haven't commented on the role of foreign bids under our competitive bidding system. We were quite embarrassed by this bid on the generators recently, where England got the low bid but did not get the reward. Would you care to comment on some of the problems, or on the proper role of foreign bidding, in our competitive bidding system?

DR. PIQUET: You open up a whole new subject, which I don't have time to touch upon. I would like to discuss it privately with some of you, or even publicly if you want me to.

I happen to have attended some meetings of the electrical trade, including a British electrical company and some of the American. The chances are that if there were no controls, the amount of business that the British electric industry or the Swiss would get in this country would be quite small, because the real barrier to the importing of those goods is not the "Buy American" provision. It is a disposition on the part of American engineers to prefer American equipment. There is a natural barrier in that respect.

Really, it is a pathetic thing that the American electrical industry has to resort to tactics like this, because if there is any one industry in the United States, next to the automobile industry, that ought to be able to stand up by itself, it is the electrical manufacturing industry. It just so happened that these generators were tailor-made jobs. We don't have a comparative advantage in that field, like we do on run-of-the-mill electric items. Therefore the British and the Swiss have a fine chance to get in, because these are tailor-made things.

The only argument that really holds any water is the national defense argument--in case of an emergency, getting the equipment repaired. The answer of the British electric industry to that is that the Canadian engineering companies could rush the parts and repair the equipment just about as fast as the parts could be rushed from Ohio or New York or from any place in the United States.

But it is a big subject, and this is a thing that has been blown up way out of proportion to its importance in the industrial scheme, as I said.

QUESTION: Would you compare the effect of free trade on our industries and the natural changes that would occur?

DR. PIQUET: I am not quite sure what you mean. Do you mean what effect going on a free trade basis would have?

QUESTION: Yes.

DR. PIQUET: I will give it to you as of 1951, when I put it in my book "Aid, Trade, and the Tariff." I took 80 percent of all imports into the United States, dutiable imports, and asked this hypothetical question: What would happen if we were to suspend tariff duties altogether?

On the basis of those 80 percent of the dutiable imports into the country in 1951, assuming that the economic conditions would remain as they were, and that it would be a temporary suspension only, and if we prorated the 80 percent over the remaining 20--there were a lot of "ifs,"--I found that the full impact of the suspension of the duties would probably be to increase the imports by a little less than two billion dollars at the maximum, and probably a little less than one billion at the minimum.

The tariff is not so vital a part of our economic program that, if it were to be abolished, it would result in a flood of imports. Not at all. But in certain lines it might be hard on certain people, like the fur-felt hat people, the cutlery people up in New England, the wool producers in the western part of the United States, the cattle processors, and the bicycle manufacturers. It might be hard on them.

But these are "pin-points" in the American economy. In total, the impact would be very slight. Therefore, I would say that if we were to do this, it would precipitate trouble in certain parts of the country that are more vulnerable, notably New England and West Virginia--places that are not on their toes economically, not adapted to the environment. In West Virginia you have coal, which is a sick industry, and hand-blown glassware, both of which are very vulnerable to import competition. You have toys, which are vulnerable to the Japanese. You have pottery and dishes, which are vulnerable to British, German, and Japanese imports. West Virginia is sick economically, because it happens to be producing goods on the low end of the efficiency scale. I don't mean that the management is inefficient, but the environment is not suited to them.

So, the impact on our aggregate national economy would be slight. But in certain localities it would be pretty high. This is why it seems

to me that when we come to stimulate imports, we ought to try to divert the increases in imports away from vulnerable areas. Why lower duties on West Virginia goods? There are lots of other imports that we can encourage, such as automobiles, where the competition would not hurt.

DR. HUNTER: Our time has run out.

Dr. Piquet, I think it is safe to say that, after listening to one of your lectures, life is never quite the same again on the international economic front. On behalf of the Commandant and all of us, thank you very much.

(15 Feb 1956--250)B/ljt